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PRIVATIZATION IN THE GULF COOPERATION COUNCIL (GCC) COUNTRIES: THE NEED AND THE PROCESS

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This paper attempts to review the importance and significance of the privatization process in GCC countries; discusses in detail the motives for privatization and the appropriate approaches towards it; and presents an action plan for such endeavor with necessary precautions. The paper focuses on four dimensions of privatization in GCC countries: the concept, the need, the prerequisites and the process. The central argument of the paper is that selection of a privatization approach depends on institutional capacity and economic and regulatory conditions. Though divestiture is the most well received approach for privatization, it should not be the dominant mechanism. Contracting-out seems a promising approach in the GCC context. However, insufficient efforts have been directed to improving public delivery systems prior to privatization.

1. INTRODUCTION

Privatization has become a reality in Gulf Cooperation Council (GCC) countries, and a rapidly developing characteristic of their economies. In Kuwait, the World Bank was requested by the government to prepare a study about privatizing the activities of the public sector. The government expressed its irrevocable commitment towards privatization. In the Kingdom of Saudi Arabia, the government has announced its intention to privatize the airline, some communication services and another 33 companies. Under its sixth five-year plan, announced in November 1994, the government will privatize some state industries, rationalize costly subsidies and invite greater private sector investment in infrastructure projects. This is in accordance with the objectives of the country's fourth and fifth development plans, in which the strategy of privatizing public enterprises was first adopted. The Government of Oman announced in 1994 a five-year plan for privatization and its first step was to divest its holding in many companies, such as Oman Cement Company, through public floatation in August 1994. A similar trend towards privatization has become apparent in Qatar, Bahrain and the United Arab Emirates (UAE). Most GCC countries (except Bahrain) so far have large holdings in public companies (Table 1). Many factors have led to the domination of the public sector in GCC countries. These include the weakness of the private sector in the early stages of

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development, the desire for income distribution and the tendency toward revenue diversification by the state through investment in non-oil sectors.

TABLE 1

Public Holding in Selected GCC Countries
(% of total equity market capitalization for 1993)

Kuwait	26
Saudi Arabia	55.4
UAE	25.7

Source: Information about market capitalization was obtained from reports of Arab Monetary Fund while those of public holding was obtained from MEED and public announcements.

Though privatization activities are currently relatively small in GCC countries, they are expected to flourish in the next five years. Table 2 shows that privatization activities in GCC countries may reach US$ 61,817 million in the next five years.

Though Islamic financing and conventional privatization mechanisms are quite distinct, they aim at similar policy objectives. Islamic financing, which is based on the principles of participation and risk-sharing, is in a way compatible with the aims of privatization. Hence, the acceptability and popularity of Islamic financing will be strengthened further with the flourishing of privatization activities in GCC countries. This is due to the fact that interests in participatory capital will intensify as a result of wide-scale privatization programs which may provide huge investment opportunities for Islamic banks.

Since privatization activities are expected to intensify and due to the fact that the GCC countries' GDP represent 20-21% of the GDP of the Islamic *ummah* GDP (IDB Statistical Monograph No.14, 1994), it seems essential to study the privatization process and challenges in GCC countries. Lessons learned from such experiences could benefit other Islamic countries, anxious to implement privatization. This study will evaluate the need for privatization in GCC countries and elaborate the process of such privatization. The study will also discuss the precautions and challenges facing privatization in these countries.

TABLE 2

Expected Privatization Activities in GCC Countries for the Period 1995-2000([1])

(in million US Dollars)

Country	Selling Public Holdings	Contracting-out	Others[(2)]	Total
Bahrain	30	200	20	250
Kuwait	2,664	12,600	1,400	16,724
Oman	100	670	200	970
Qatar	100	500	-	600
Saudi Arabia	8,373	20,000	1,500	29,873
UAE	2,400	11,000	-	13,400
Total	13,667	45,030	3,120	61,817
% of Total	22.11	72.84	5.05	100.00

(1) This rough estimate has been made from data collected and compiled by the author from different sources, including MEED, Financial Times, Government reports, IMF and World Bank Reports.

(2) This includes other forms of privatization such as leasing and sell-lease-back.

2. THE CONCEPT

Although privatization is first and foremost a political process, it has been implemented as an economic exercise. Privatization originated from the principal-agent and property rights (control rights over assets) approaches used to explain how the transition in ownership leads to change in the objectives and incentives in the firm and hence the behavior of the management. In a public firm, the government is imperfectly informed about costs or demand. Typically it fails to achieve Leibenstein's X-efficiency[1] and allocative efficiency.[2] Nevertheless, the efficiency

[1] X-efficiency refers to the ratio of inputs to outputs and it is related to behavior process within the firm, such as incomplete labor contract (workers pursue their own goals rather than organizational goals), the production function is unknown and not all inputs are marketed or if marketed are not available on equal terms to all buyers. The theory argues that under pressure (open competition), the firm suppresses some of its contrary or inconsistent motivation and is likely to get closer to maximization of output. When a manager's income depends on profit, he has an incentive to produce X-efficiency; however the price will be set according to monopoly pricing, which is allocatively inefficient.

implications of such privatization will depend upon the competitive forces and regulatory conditions in which the firm functions (Vickers and Yarrow 1991). In addition, theories of bureaucracy which analyze the public sector supply, especially the budget maximization principle, have been influential in stimulating the trend toward privatization (Niskanen 1973). The principle advocates that bureaucrats' objective is to maximize the size of the budget to increase their personal utility and they exchange some agreed level of output for a budget which equals the total value of output to the public. The major impact of these theories has been in their focus on inefficiency and waste in the public sector and in encouraging potential means for organizing the supply side of public services, including shift in ownership and property rights.

The basic assumption of privatization is that the government should not carry on any activities which could be performed equally well or better either by the private sector or by an independent organization operating on free market principles (Van de Ven 1994). The shift of such activities to the private sector will confine the role of the government to key tasks and will improve the efficiency and quality of services delivered, through application of market forces. However, despite the economic rationale underlying the presumed efficiency benefits of privatization (in its different forms), neither the fundamental economic argument nor the available evidence assert blanket acceptance of privatization (Prager 1992:73). In other words, the superiority of privatization will depend upon the options considered and conditions prevailing. This is why privatization is not a universal remedy. Its benefits depend on the circumstances and the economic conditions.

Many authors have offered different definitions of privatization, such as denationalization, divestiture, opening the economy, etc. (Ahmad 1990:66). Privatization usually involves divestiture options and non-divestiture options. One comprehensive definition was offered by Dunleavy (1986:13) who defined privatization as "the permanent transferring of services and goods production activities previously carried out by public service bureaucracies to private firms or to other firms of non-public organization." Others have argued that 'privatization' should not be understood in the structural sense of who owns the enterprise, but rather how far the operations of an enterprise are brought within the discipline of market forces (Beath 1989:4). Privatization should be seen as part of a continuum of possibilities comprised of three options: ownership, organizational and operational change. In developing countries, forms of privatization are various; however, contracting-out is the form most widely employed, even to the extent that scholars suggest that the term 'privatization' should be avoided and the term 'contracting' should be used instead (Kolderie 1986:287). Though we agree with such an interpretation, in this paper we will review the possible approaches for privatization available to GCC countries.

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[2] Allocative efficiency is a by-product of a perfectly competitive market where joint efficiency in production and exchange exist and the set of relative prices is equal to the marginal costs of production.

3. THE NEED

Privatization in GCC countries must be viewed from historical and social perspectives. Historically, the economic systems of GCC countries were based on the principle of free private entrepreneurship, with minimum government participation. This laissez-faire policy was altered by the domination of the public sector in the past four decades, due to the shift of wealth from the private sector to the state. Currently, the private sector contribution is in the range of 30-40% of GDP. Thus, there is a need for more private sector participation.

Privatization is now flourishing everywhere. Table 3 shows that from 1989 to 1992, privatization activities grew by 267% per annum in the Islamic countries, and by 82.65% per annum in other developing countries. GCC countries, as part of the global economic system are joining this crowd using privatization as a remedy for their financial problems.

TABLE 3

Increase in Privatization Activities in Some Regions (1989-1992)

(in million US Dollars)

Year / Countries	1989	1990	1991	1992	Annual % Growth
Developed countries	20,945	17,997	31,058	24,398	5.22
Developing countries	3,817	7,337	17,424	22,260	82.65
Total	24,762	25,334	48,482	47,658	24.39
Islamic countries*	105	1,195	190	2,005	267.3

*These include Turkey, Pakistan and Malaysia.
Source: Schwartz and Silva Lopes, 1993.

Since it is difficult to measure the success of privatization by measuring its financial implication, a meaningful conclusion could be reached by measuring it against the motives of privatization (Dunsire 1990:51). As such, it is essential to start with a review of motives for privatization. The need for privatization in GCC countries has been initiated and strengthened lately due to many motives. The most prominent one is the decrease in state revenues and subsequent increase in the continuous deficit. The deficit of GCC countries (excluding Kuwait) as percentage of their total GDP reached -5.53%, -20.72% and -6.48% in the years 1990, 1991 and 1992 respectively (Table 4). This problem was aggravated by the inability of the state budget to continue supporting ailing enterprises and the need for relief from the financial burden (e.g. subsidies and debt requirement) of such enterprises.

TABLE 4

Deficit/Surplus of GCC Countries as % of GDP (1990-1992)

	Deficit/Surplus ($ millions)			% of GDP		
Country	1990	1991	1992	1990	1991	1992
Bahrain	-103	-60	-191	-2.55	-1.41	-4.26
Oman	469	-21	-565	4.46	-0.20	-4.92
Qatar	-403	170	-257	-5.49	2.48	-3.37
Saudi Arabia	-6,661	-33,625	-11,118	-6.36	-28.49	-9.55
UAE	-2,156	-2,371	456	-6.40	-6.99	1.3
Sub-Total	-8,854	-35,907	-11,675	-5.53	-20.72	-6.48
Kuwait	-1,371	-25,383	-18,627	-7.53	-234.53	-99.01
Total	-10,225	-61,290	-30,302	-5.73	-33.3	-15.23

Source: Joint Arab Economic Report, 1994, p.226 and p.299
Note: Data for 1992, are primary actual.

The second motive for privatization in GCC countries is the need to achieve efficiency and better allocation of scarce resources by making public enterprises more responsive to market and commercial conditions. For example, during the years 1981-1991, 11 public companies in Kuwait were generally losing 50% of the time.[3] Though no data are available for GCC countries, it has been established that there is huge social opportunity cost of public enterprise losses. Table 5 shows the potential increase in education and health expenditure in some Muslim countries, if public enterprise losses were eliminated.

TABLE 5

Social Opportunity Cost of Public Enterprise Losses in Some Muslim Countries (1988-1990)

[3] *Al-Qabas* Newspaper, No.7034 dated 4/1/1993.

Country	Estimated loss of public enterprises as % of GNP	Public education and health spending as % of GNP	Potential increase in education and health spending if public enterprise losses are eliminated (%)
Bangladesh	3	3.1	97
Turkey	4	4.6	87
Egypt	3	11	27

Source: UNDP, Human Development Report, 1993

A third motive may be the effort to increase the role of the private sector in the economy by transferring responsibilities for the production of goods and services from the public to the private sector. This is in line with the basic objective of GCC countries of promoting non-oil sector. This is supported by the high government consumption as percentage of GDP, which during 1988-92 was in the range of 20-40% (Table 6).

A fourth motive in the context of GCC countries is that privatization can be used as a tool to check capital flight from these countries. The Bank for International Settlements (BIS) estimated that Gulf countries have international deposits of more than US$ 120 billion.[4] These amounts could be utilized in privatization activities.

In addition to these obvious factors, there are others which are less obvious, such as the functioning of the labor market. Government wages continued to be above those in other sectors and un-related to market conditions, leading to severe fiscal drain. Privatization is expected to encourage the diversion of native labor toward more productive activities and to adjust salaries in line with the market. Another reason for introducing privatization is to allow competition, which will lead to improvement in productivity of the indigenous labor, encourage its participation in the private sector and reduce the sector’s dependence on foreign labor. In addition, such transition will lead to separation of social benefits from employment earnings and a greater shift towards a market-based economy.

TABLE 6

Government Consumption as Percentage of Gross Domestic Product (GDP) In GCC Countries

[4] Bank for International Settlements, International Banking and Financial Market Development, Basle, May 1995, p.18 and p.25.

Year / Country	1988	1989	1990	1991	1992
Bahrain	26.9	26.5	25.8	NA	NA
Kuwait	26.3	25.4	38.7	201.1	40.7
Oman	32.7	30.2	38.1	35.6	39.3
Qatar	44.3	NA	NA	NA	NA
Saudi Arabia	34.2	31.0	31.8	38.2	NA
UAE	21.5	19.6	16.3	17.0	17.6

Sources:
1. UN National Accounts Statistics 1991.
2. Central Bank of Kuwait, *Quarterly Statistical Bulletin*, April-June 1994.
3. Central Bank of Oman, *Quarterly Bulletin*, December 1991 and December 1993.
4. Ministry of Planning, Kingdom of Saudi Arabia, Achievements of the Development Plans 1970-1993.
5. Ministry of Planning, United Arab Emirates, Annual Economic Report, 1993.

In other countries, such as the UK, additional motives like the expansion of ownership base and installing market economy competition were basic motives for privatization efforts (Vickers and Yarrow 1991:157). However, such motives are not dominant in the GCC countries. The policy measures of all GCC countries indicate that the main objectives of the privatization process are reduction of the public deficit, elimination of subsidies and relief from financial burden. Although, these, rather than political motivation or efficiency considerations, are the main motivations, nevertheless, the economic benefits of privatization in GCC countries will be maximized only if governments make efficiency enhancement and promoting competition, major goals.

4. THE PREREQUISITES

Before implementing the privatization process in developing countries, three serious obstacles have to be tackled: strong opposition from the work force, political opposition and fear of economic concentration (Beath 1989:40). It is essential to have a firm political commitment to privatization to overcome such obstacles. In a survey of selected Saudi businessmen, many reservations were expressed about privatization, such as work force opposition (54%), the inability of the private sector to absorb the huge public assets (37%), and economic concentration (37%) (Chamber of Commerce 1990). Nevertheless, in GCC countries, these obstacles are not significant, except the resistance from political opposition and public opinion. The main concerns of the public, which need to be addressed, are the fear of public subsidies being reduced, the selling of public assets below the market price and the concern that such measures will reduce indigenous workers and replace them with low cost foreign labor. GCC countries should consider these factors while deciding on the sectors and companies to be disinvested, as well as the timing and period of privatization for each sector/company.

In order to avoid any setbacks to the privatization process and to overcome any resistance, a strategy for privatization and a timely action plan should be prepared. Such strategy and plan may include defining the scope and objectives of privatization, increasing public awareness, addressing the concern of consumers, generous allowance and compensation for affected workers, training and redeployment of redundant work force, provision of ownership to work force through different means and incentives, provision of safeguards, avoiding economic concentration and enacting strict control, including holding part of the shares or having the golden share.[5] Also, the strategy should include establishing a procedure for fair evaluation of public assets, greater transparency for the selling process, and establishing a mechanism for monitoring and evaluating privatization.

The *first* prerequisite of successful divestiture and contracting out, is the existence of an effective private sector. Due to many deficiencies in the private sector in GCC countries, the benefits will be less than those to be gained from privatization in developed countries. The first deficiency is the lack of professionally qualified managers in the private sector, due to the restriction on foreign ownership. Another deficiency is that most of the candidate companies depend on public-sector subsidies or monopolies. In such cases, privatization will not reduce the burden on the treasury and may lead to abuse of the monopoly granted. The fear is that privatization may create a private sector which depends mainly on monopolies and subsidies, which may retard the efficiency and development of this sector.

A *second* prerequisite for success is a developed capital market and stock exchange and the existence of restrictions on foreign ownership.[6] In many developing countries, privatization has been hampered by the lack of capital markets and limited credit facilities (Cowan 1987:11). The importance of such conditions lies in the fact that divestiture in a limited capital market may lead to concentration of wealth or the control of strategic sectors by foreigners. In GCC countries, the capital market is not adequately developed to overcome this problem. Furthermore, the market capitalization is not adequate to absorb the expected divestiture activities. For example, market capitalization for GCC countries (except Kuwait) was US$ 23 billion in 1992 (Table 7), while total privatization activities per year are expected to be approximately US$ 9 billion (Table 2).

In addition, tight restrictions on foreign ownership exist which will not allow for wide competition in privatization. The need for further scrutiny and greater transparency in the existing domestic exchange is also essential, to encourage in-

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[5] The golden share is a concept that was created by the British government to maintain its control over the public enterprises that were privatized. Such a share gives the owners the right to accept new shareholders or put limits to the existing holding (Dunsire 1990:49). Usually, this approach is used to prevent foreign ownership or economic concentration.

[6] Equity market development is essential for the success of any privatization program (David Gill 1989:132; Alan Walters 1989:33).

vestors to come forward. Other measures could be implemented to increase market capitalization, such as creating funds and allowing institutional investors and holding trusts to participate in the equity market. Furthermore, if privatization was implemented gradually, the excess funds deposited outside the region would be sufficient to fill any gap in the equity market. The level of development of the capital market will determine the applicability of any given privatization mechanism and the pace of privatization.

TABLE 7

Market Capitalization

	Market Capitalization (in million US$)				Annual % growth
	1989	1990	1991	1992	
Bahrain	2973	3174	4175	4407	14.02
Saudi Arabia	13174	14200	14800	17300	9.51
Oman	982	1272	1504	1516	15.58
Sub-total	17129	18646	20479	23223	10.68
Kuwait	10204	-	-	-	-
Grand Total	**27333**	**18646**	**20479**	**23223**	-

Source: Arab Monetary Fund based on information obtained from GCC Stock Exchange.

A *third* prerequisite, is the availability of suitable and transparent legal framework and economic environment for successful privatization (Poole 1987:44). The focus of regulatory activity should not be only pricing, but also the regulatory incentives for investment behavior. The existence of uncertainty, especially in terms of regulations, will hamper the process of privatization in GCC countries. Furthermore, strengthening the transparency process which includes competitiveness and adequate bidding procedures, a clear selection mechanism and sufficient disclosure of bids and deals, will help establishing confidence in the market.

The *fourth* prerequisite is efficient dissemination of information, including the existence of performance indicators for public enterprises and goods and services produced. In the absence of such information, investors may lack confidence and will be deterred from involvement in the privatization process. Furthermore, performance indicators will provide insight into the challenges that face such enterprises and influence the desire for investment.

The effort to liberalize the economy from all restrictions such as wage and price controls, the introduction of competition and increase of deregulation activities, are sometimes considered as a one technique of privatization, while in some instances they are considered as a prerequisite for effective privatization. For example, most public enterprises in GCC countries follow the civil service rules and regulations which make the lay-off of redundant labor force a Herculean task. Unless such restrictions are lifted, it will be difficult to restructure the targeted enterprises. Furthermore, the distortion in the system of commercial incentives in GCC countries, which provides protection through an agency system, should be rectified in order to disable the private sector from rent-seeking activities.

Based on the above prerequisites and after evaluating the circumstances currently prevailing, it seems that the environment in GCC countries is not yet entirely conducive to successful privatization.

5. THE PROCESS

Many techniques are available for privatization;[7] nevertheless, only a few can be applied in the case of GCC countries. While divestiture (sale of public enterprises) is the most accepted form of privatization, other alternatives are equally important, such as contracting-out, which may constitute 72.84% of privatization activities in GCC countries (Table 2).

The cost of privatization is an essential factor in choosing from available alternatives. Every country has to carefully examine the costs of different scenarios prior to adoption of any action plan. Though most GCC countries could finance any privatization program easily, the cost of administration is particularly important at present, due to the financial constraints facing these countries. Costs will depend on many policy directives and factors, such as potential approaches in maximizing proceeds of sale, low pricing to assure widespread ownership, the cost of restructuring public enterprises before privatization, administrative and monitoring expenses, and the cost of absorbing labor redundancies. Furthermore, the cost may include possible residual cost of divestiture, such as any continued budgetary burden or the assumption by the government of long term liabilities of the privatized entity.

In the following paragraphs, we will discuss four of the best known privatization techniques, namely; divestiture, contracting-out, corporatization of government entities and improvement of public delivery system.

5.1 Divestiture (selling part or total public assets)

[7] Pirie cited twenty-one methods of privatization (Pirie 1988).

Divestiture is defined as the selling of whole or part of the public share or disposing of the business element of the public sector. It is the most well received approach to privatization in GCC countries. The World Bank report (1993) submitted to the government of Kuwait suggested that it sell its public holding in 74 enterprises. Oman, where privatization is envisaged to be implemented in five years, adopted three approaches in divestiture. The first was to transfer the government shares in companies to the public either through Muscat Exchange (Oman Hotels Co. and National Insurance Co.) or through direct public offering (Oman Cement Co.). The second approach was to sell some of the public assets, such as hotels, by establishing a specialized public company and offering its shares to the public. The last approach was to allow private enterprises to own public facilities, such as power stations. In Bahrain, the government continues its commitment to disinvest its holding in public companies, such as Gulf Trading and Food Processing and Bahrain Aluminum Extrusion Company through public floatation.

Suggested Steps for Divestiture

An action plan for divestiture is an integral part of any implementation plan. Such a plan may be prepared after reviewing the experience of privatization in similar countries, in order to avoid the difficulties they have encountered. Suggested steps for such an action plan are the following:

A. The creation of legal means for privatization (if needed)

The ease or difficulty of any privatization program will depend on the authority needed for such a process. The authorization may be decided based on the existing legal requirements in each country. Legislation should provide the unit responsible for privatization with the necessary power to undertake creation or dissolution of public enterprises and transfer of public assets. The GCC countries could adopt different approaches for authorization according to the objectives of privatization, the nature of transaction, and prevailing political system and constitutional requirement. Approaches for authorization may include individual or overall legislative authorization and individual or overall executive authorization.

B. The selection of a target group through policy review, organizational survey, business evaluation and strategic analysis (Marston 1987:68-9)

One approach towards this, is to classify enterprises according to predetermined criteria. This is essential because we have to recognize the great differences that occur among public enterprises. In Nigeria, prior to privatization, public enterprises were classified into five categories: (i) to be fully privatized; (ii) to be partially privatized; (iii) to be fully commercialized; (iv) to be partly commercialized; and (v) to remain as public institutions (Beath 1989:38). In addition to this useful classification, the GCC countries may consider the option of liquidating hopeless enterprises.

C. The preparation of enterprises for privatization

Such preparation may include restructuring the capital structure, laying-off redundant workforce, reorganization of activities, improving the market situation and increasing the performance of the enterprise (Walters 1989:31-3; Al-Saigh and Buera 1990:126). Furthermore, it may include actions to deregulate and improve competitiveness in each sector and to ensure conditions for efficient monopoly control (if any). In addition, there is a need for major change to achieve the level of reorganization suitable for corporatization/privatization, including internal organization, financing structure, employment conditions, organization structure, change of management and decision making process and corporate philosophy. Training may be used as an effective tool to introduce the new ethos to the target enterprise. The nature and scope of such preparation will depend on the circumstances prevailing in each enterprise and on the conditions of the country’s economy.

Many public enterprises in GCC countries are suffering from losses and other deficiencies which make them unattractive to private investors and will require extensive restructuring. Privatization of such enterprises would have only a marginal impact on reducing the scope and the burden of the state.

D. Increasing the capacity to manage and monitor feedback of the privatization process

An important ingredient for the success of any privatization program is the country's capacity to manage privatization effectively (Nellis and Kikeri 1989:77). A body or steering committee or specialized ministry could be established with the necessary authority to foster and monitor the privatization process. A time frame for privatization could be prepared with reference to enterprises, sector and the economy (Wiltshire 1986:350; Ahmad 1990:78). Furthermore, a feedback mechanism is needed to spot interest group resistance, work force reluctance and any other obstacles to privatization and to respond to them in an appropriate manner.

E. Marketing and dissemination of information

Failure of many privatization efforts is attributed to the lack of information dissemination to potential investors, workforce and the public. The UK experience shows that successful privatization has been mainly due to the wide dissemination of information to the public. Such dissemination may include the objectives of the enterprise, its financial position and the potential for the future.

The marketing effort which is an important ingredient of the process, could include encouragement of small participants through preferential allotment of shares and phased payment, pursuing many channels to attract potential investors and well planned media publicity. This is essential in countries, such as GCC countries, where transparency, public control and market information are not adequate.

F. The selling stage

As a result of the under-developed capital market, it is extremely important for GCC countries to focus on this stage. This stage may include steps such as enterprise valuation, fixing share values through a special entity or task force, the formulation and implementation of a marketing plan, and finally divestiture of candidate enterprises through various techniques. A major factor for success of the selling stage is the capability of the private sector. This in turn depends on three factors: (1) the vision of the private sector about the future, (2) performance of these enterprises, and (3) the financial ability to buy such enterprises. The adequacy of absorptive capacity of the private sector varies from one country to another in the GCC region. For example, in Kuwait, the ability of the private sector to support the privatization process is doubtful. Potential investors are part of the debt restructuring plan and they lack the financial leverage necessary for such deals. However, if the privatization process was phased in such a way as to take into consideration the absorptive capacity of the private sector, the process may be effective.

Since most of the privatized enterprises are likely to have complete monopolies, it is necessary that such privatization is accompanied by the setting up of a regulatory framework for constraining and monitoring monopoly power. Otherwise, such monopolies could be abused for private gain. One alternative is to establish a benchmark against which the newly privatized enterprises or operations could be evaluated and judged. Furthermore, there is a need to assess the distributional implications of divestiture, especially in GCC countries where it ranks high in development objectives. Such assessment could be made in the light of the profit status of the enterprise(s), the scale of sale, the pricing, the evolved pattern of ownership and the degree of monopoly enjoyed (Ramandham 1989). The concentration of strategic sectors in the hands of a few families or interest groups should be avoided. Privatization should aim at distributing ownership among a wide spectrum of citizens.

G. The utilization of privatization proceeds

A major policy is to decide on how to utilize cash coming from the privatization process (Heller and Schiller 1989:98). In GCC countries, those proceeds could be used to cover areas such as current expenditures, financing the restructuring of other public enterprises and reducing public debt.

If the problems of selecting the acquiring investors and pricing the assets are overcome, disinvestment provides the quickest, simplest and most flexible approach to privatization.

5.2 Contracting-out

The *second* technique, by which a major reduction is envisaged in the scope of bureaucracy, is in the area of contracting-out public services (fully or partially) to private enterprises. In such a technique, the financing will continue to be in the public sector, whereas producing goods and services will move to the private economy (Pirie 1988:140). Here, the government will still be responsible for guaranteeing a supply, though it does not produce it. This approach has the advantage of amalgamating both the public and market supply of goods and services. Contracting-out services, which implies the separation of purchasing from provisions of services, is gaining acceptance in many developed and developing countries, including GCC countries. Since the major privatization expected in the utilities sector in GCC countries will be a complex process, a piecemeal approach, such as contracting-out, is warranted. Electricity, water and telecommunication offer the greatest potential for private sector involvement through contracting-out, due to their sustained demand, poor existing services and the ease of payment collection. However, unless the management capacity is enhanced, the existing limited capacity of the private sector may hinder such a shift toward contracting-out.

In Kuwait, the approach of contracting the provision of public goods to the private sector has been widely used. In many budgetary directives, the Ministry of Finance has encouraged the Ministries and the public agencies to contract private firms for services like security and cleaning. In addition, Kuwait envisages the transformation of some services (Public Health, Post, Telephone and Electricity) into mixed enterprises. In Oman, the first privatized power station (Menah) was launched recently and its shares were floated in November 1994. In addition, the Government of Oman has requested bids to expand the Muscat Waste Water System on a 30-year build-own-operate-transfer approach. Similar arrangements have been made for a power plant in Bahrain, which will be built and operated by a consortium led by British Gas.

Some of the prerequisites for successful divestiture such as overcoming opposition from the workforce and the existence of effective private sector, are equally important for contracting-out. In addition, contracting-out will be efficient when certain conditions prevail, such as availability of economies of scale for the services, wider scope, adequate organization, existence of competition and sufficient capacity for managing contracting-out (Prager 1994:183).

Since contracting-out combines both bureaucratic and market supply of goods, it may lower the cost only if the potential contractor operates in a competitive market with an adequate number of competitors and no collusion. The process, to be effective, should include many steps, such as contract preparation, selection, bidding, control and monitoring.

In contract preparation, there is a difficulty in defining demand and the appropriate pricing policy. Furthermore, there is a need to establish a complex set of contractual relationships to meet complex obligations. Also, it will be difficult to assess contract compliance and to have legally enforceable contracts in GCC countries due to moderate administrative and financial capabilities and modest legal system.

The most complex and challenging task with regard to contracting-out is the process of selecting the contractor. It is essential to use a pre-selection procedure, whereby only companies known to be reputable and able to provide the required services and goods are included. In addition to lower cost, the past record and reliability of contractors need to be evaluated, and their managerial capacity and financial packages need to be assessed. Since it is difficult and expensive to indicate all specifications, the selection process and competition aspects play a vital role in the effectiveness of contracting-out.

On the bidding side, it will be difficult to determine the services needed from quality and cost aspects. Also it will be difficult to introduce the element of incentives for contractors in such bidding. Furthermore, the complexity of processing and evaluation of bids may increase the transaction costs involved in contracting-out.

Another difficulty is contract compliance, which is evaluated through monitoring. Contracting-out should be resisted unless the principle of contract management is acceptable and adequate resources are devoted to financial and technical monitoring of contracts. Efficient monitoring, though costly, will recover its cost by preventing over-pricing and inadequate quality. There is a need for regular assessment and respecification and continuous monitoring of incentives provided and cost control. Some countries which practice contracting-out include contract compliance within the scope of the audit of their public sector accounts.

Contracting-out is expected to be the most popular and effective method of reducing government expenditure and improving the efficiency of government services in GCC countries. The benefits of contracting-out emanate from improvement in the technology of production and its subsequent impact on reducing unit cost, increasing the efficiency of the organization structure and increasing market competition. Furthermore, contracting-out is less costly from a political standpoint than a running battle for internal reform and efficiency (Prager 1992:104) or external challenge and maladministration allegation in the divestiture approach.

Contracting-out is not without its drawbacks. The lack of technical expertise and moderate administrative capacity in the GCC countries will lead to inefficient monitoring. Furthermore, lack of transparency and modest auditing capacity may lead to increase in maladministration. Contracting-out may affect the career of public employees, reduce the quality of services, cause interruption of services for civil servants and may lead to a loss in tax revenues.

The way contracting-out is applied also involves many risks. For example, in areas where cost-plus contracting is feasible, such as health services, there is an element of moral hazard, since the contractor has no incentive to bring the cost down. Contracting-out needs to be monitored continuously, since its viability is based on certain ingredients which may change according to the prevailing circumstances.

There is a need to assess the costs involved in contracting-out. The cost of contracting-out (tender document preparation, bidding, etc.) and contract monitoring plus contractor change may exceed the cost of internal production, which will render it inefficient. In addition, the complexity of the mechanism of contractual relationships necessitate that policy makers reflect on the optimal contract design, to reach the desired efficiency.

5.3 Corporatization of Government Entities

The *third* technique for privatization is the corporatization of government agencies into entities which have separate legal status. The objective of such corporatization is to reduce government control over such agencies and to increase the impact of market forces (Van de Ven 1994:373). The government, after corporatization, will act as a normal shareholder and will refrain from using its influence to achieve political or other objectives which run contrary to the profit-seeking objectives or market forces (Van de Ven 1994). Corporatization implies that assets are recorded and valued, contractual obligations are recognized and appropriate capital structure is reached.

In this approach, the government still owns the enterprise. However, its control or influence is less and market forces play a more decisive role. The candidates for corporatization may include, but not be limited to candidates for divestiture, public companies or state-owned investment companies. In addition, corporatization is an effective mechanism for privatizing semi-public organizations and independent agencies (museums, printing and publishing companies), public corporations (airlines) and government service departments (land registration). One mechanism for such corporatization could be to establish a limited liability company under the company law. An example is to incorporate printing and publishing activities as a public limited company wholly owned by the state. Another potential arrangement in GCC countries could be to gather all computer centers and establish a company to absorb those centers. Such a company to be contracted for a number of years by the concerned departments. Another mechanism for corporatization could be to establish a legal entity governed by the public law issued by parliament, e.g., in the case of shipping-traffic services. In such arrangements, the main elements would still be regulated by law, but services would be rendered on the basis of market forces. Corporatization is sometimes used as an intermediate stage toward selling all or part of public enterprises. Such corporatization may lead to a better market value for public stock in the event of divestiture.

Parallel with corporatization, incentives for greater efficiency and profitability could be introduced. In addition, a control and monitoring system could be established to ensure that such corporatization pursues efficiency and profit maximization.

5.4 Improvement of Public Delivery System

The *fourth* technique, which poses challenges to GCC countries, is the improvement of public delivery system. The importance of this approach[8] originates from the fact that improving allocative efficiency is not attributed to the change in ownership, but rather to increasing competition and decreasing of monopolistic or quasi-monopolistic advantages of public enterprises.

It is essential to understand the difference in the role of public enterprises in developed and developing countries. Most privatized enterprises in developed countries, such as the UK, are commercially run and do not play any developmental role, nor are they utilized as tools for wealth distribution. As such, it is easy to restructure and privatize them with minimum social cost. In contrast, the public enterprises portfolio in developing countries such as GCC countries is so heterogeneous in terms of objectives, costing structure, profit efficiency and organization structure, that extensive restructuring is required prior to divestiture. This makes the financial and social cost of divestiture high as compared to developed countries. Bearing in mind this difference, the public enterprises in GCC countries could be developed better through the four proposals to increase incentives for internal efficiency suggested by Vickers and Yarrow (1991:151-52) rather than by divestiture. The four proposals include the use of performance-related incentives, establishment of special regulatory bodies, the introduction of a more competitive environment and the creation of an efficient audit organ. With such an approach, significant improvement in efficiency of public enterprises may be achieved, while maintaining public ownership. An important issue to bear in mind is that it is better and easier to look inward more (for internal efficiency) and outward less (wide variety of institutional arrangements). Improving the efficiency of the public delivery system may prove an inexpensive and less controversial option compared to contracting-out and divestiture. Tighter financial controls and scrutiny of public enterprises, developed in the UK in 1970s and 1980s, could be a guide to GCC countries in their pursuit of such a technique. This may include actions such as more cost-benefit analysis, introducing costing of alternatives in policy making, improving cost-consciousness and enhancing the audit function and review.

The existence of participatory institutions and the transparency of decision making will lead to the improvement of the delivery system, as these conditions will make it more difficult for bureaucrats to take advantage of their powers.

The main argument here is that insufficient efforts have been made in GCC countries to introduce significant improvement in performance of public enterprises, while maintaining public ownership. Better management through offering

[8] Sometimes referred to as the introduction of competitive features into the public sector.

incentives, rewarding innovation and encouraging minimization of production costs is one possible approach toward improving the public delivery system. Furthermore, bringing greater accountability to the public and customers will lead to improvement of the public delivery system.

6. CONCLUSION

The privatization process in GCC countries will very much depend on each country's needs, regulatory conditions, adequacy of private sector and management capacity. Any country which decides to implement the privatization process, should answer the question, "would it be better to use one approach or a variety of approaches?" The need in GCC countries is to approach different forms of privatization pragmatically rather than through unplanned reactions or political maneuvering. The main argument of this paper is that the desirability of privatization depends on the options available and prevailing circumstances. The case of each country in GCC is unique and requires a different remedy. The main objective of any privatization is to increase effective competition and improve long term effectiveness of the regulatory capacity and policies. While most attention is given to divestiture, contracting-out is the most important approach to privatization in GCC countries. Due to weak institutional abilities and inadequate regulatory capacity, a non-divestiture approach, such as contracting-out, is preferred over ownership change. Though it has the potential to thrive, the lack of many prerequisites for successful privatization, such as regulatory capacity and adequate capital market, will hinder the privatization process.

The availability of a wide selection of approaches towards privatization suggests the need for a clear policy on it. This will include the mission or objective, the strategy and the consequences or achievement. What is necessary in the context of GCC countries is not a change in ownership, but rather to increase competitiveness and a favorable regulatory environment. Since change of ownership in GCC countries is far from being the main factor for efficiency improvement, improving the system of internal delivery seems a promising and reasonable option prior to privatization.

The main challenge to the GCC countries is not whether to pursue privatization or not; it is rather how to implement the privatization program effectively to achieve equity, accountability and cost efficiency.

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