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Chapter 4

Implications of the diverse objectives of MENA state-owned enterprises

Extra-commercial objectives pursued by SOEs have a number of implications on MENA economies. First, SOEs, much as the overall public sector, are often forced to create employment opportunities in order to absorb excess labour force, in detriment to their productivity. Secondly, SOEs' social objectives and the manner in which they are compensated for fulfilling them, have serious implications for the emergence of a level-playing field between state-owned and private sector incumbents. Third, the lack of transparency and accountability in some SOEs has led to the emergence of allegations, and in some instances evidence, of corruption in these companies. Taken together, these trends have created a situation where many SOEs are either unprofitable or loss-making, weighing heavily on government budgets which are under significant strain in recent years in most countries of the region. Good corporate governance for SOEs is increasingly seen as part of the solution to the corruption and even performance-related challenges faced by SOEs.

The characteristics of MENA SOEs discussed in the foregoing sections of this report – including non-commercial objectives, privileged and strategic status, diffuse governance, and often mixed commercial outcomes – raise a number of strategic policy issues. The second half of this report focuses on the consequences that MENA SOEs' broad objectives have for local labour markets, government budgets, competition, and the quality of governance and anti-corruption agenda in the region.

Labour market implications of MENA SOEs

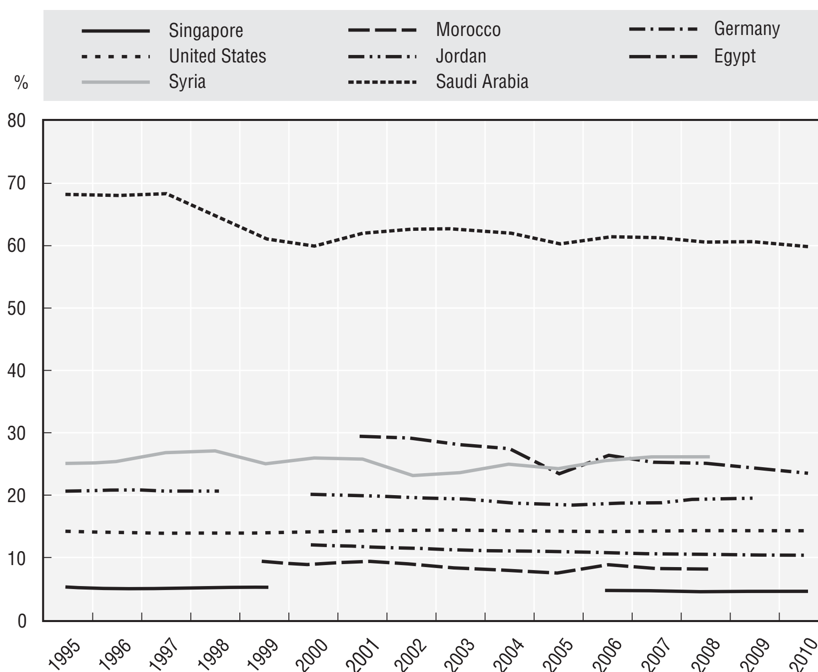
In addition to contributing to social objectives as outlined above, SOEs are in some cases charged with labour force development objectives and in some countries are forced to over-employ in order to absorb excess labour not able to find employment in the private sector. Reform of large SOEs, especially those located in remote locations, can be contentious since it may result in layoffs which may be socially and hence politically unacceptable, particularly when alternative employment opportunities are difficult to find and where entire families are dependent on a single breadwinner. Maintaining employment through SOEs is not an uncommon strategy across the region, regardless whether this employment is productive or not.

The full extent of employment by SOEs across the region cannot be established due to the lack of reliable statistics, although figures regarding the size of the overall public sector employment are telling. In Kuwait – a country with a particularly large public sector (relative to the size of its economy) – it is reported to employ 76% of the national labour force.[1] This figure includes a variety of state owned enterprises, notably in the petroleum sector which accounts for over 90% of Kuwait's exports. Likewise, in Saudi Arabia, Egypt, Algeria and Syria, the state remains one of the largest employers, although generally in the GCC, over-employment tends to be more prevalent in the ministries than in SOEs.

In Saudi Arabia, the salary and benefits bill for the entire public sector is more than double that of the private sector (Central Department of Statistics & Information, 2013), even before the 2011 decision of the King to provide a 15% salary increase for all public sector workers as well as an additional two months' salary. The IMF estimates that the MENA region has the highest central government wage bill in the world, at close to 10% of the GDP, as opposed to just over 5% globally (IMF [b], 2012).

This reflects both the size of the public sector and the fact that public sector wages are on average 30% higher than those in the private sector (whereas in the world in general, private sector wages are 20% higher on average than public sector wages) (ibid.). This is particularly so in select SOEs which are considered as strategic and where the imperative to attract high calibre staff facilitates their exemption from remuneration scales that may apply to other SOEs or the public sector at large. That said, the job creation from companies operating in strategic sectors such as petrochemicals is often low.

Figure 4.1. **Share of government employees in economically active national population**



Source: World Bank, ILO, Saudi labour force survey, SAMA.

We do not have up-to-date aggregate and comparable employment figures for most MENA SOE sectors. Company-level information in many cases however points to over-staffing and conflicts between efficiency objectives and welfare state prerequisites. Welfare objectives are not only factored into output pricing but also in staffing decisions. With lagging growth, unemployment typically well above 10% and with local private sectors creating few well-paid and attractive jobs, SOEs have been an important employment generator, much like the rest of the public sector (World Economic Forum, 2012).

For instance, while Emirates employs a staff of about 40 000 and operates almost 200 planes, Kuwait Airways employs a staff of 5 000 while operating only about 10 functioning planes, a staff-to-plane ratio that is about three times as high. Job security for existing staff has been one of the main stumbling blocks in the negotiations over Kuwait Airways' privatisation. Over-employment in the mostly state-run Egyptian textile sector, which employs a total of 400 000 workers, is well-documented (El-Haddad, 2012). In Syria, extensive over-employment has been documented, and throughout the late 1990s and 2000s, wage growth in SOEs exceeded productivity growth. At the same time, salary scales aim to create socialist style egalitarianism in that a worker with 20 years on the job can receive a salary equivalent to that of a freshly appointed general director.[2] Redundancies almost never happen and there is no effective performance monitoring.

According to World Bank research, over-employment in Algerian SOEs has been endemic, with levels of employment unrelated to performance. SOE social services obligations for workers and their families have historically been extensive, and wages, by and large, have followed the general – more egalitarian – public sector pay grid, despite formal autonomy to deviate from it. Employment has been given preferably to veterans of the independence struggle and their descendants. Reflecting its populist ideological origins, the government has given a prominent political role to state-controlled unions which have defended public sector workers' entitlements.

As mentioned above, a halving of the industrial production between 1986 and 1996 in Algeria was not accompanied by any cuts in the workforce. While the SOE sector has been gradually slimmed down since then, it has by and large not reached private sector efficiency levels. In 2004, 690 000 workers were employed in public transport and service sectors, more than 100 000 in Sonatrach and its affiliates (IMF, 2006), while 370 000 Algerians worked in more than 1 000 other SOEs (IMF [a], 2008). Likewise, in Iraq over employment by SOEs is dominant. In 2004, some 500 000 individuals were employed in SOEs (World Bank, 2004). Used as a tool of employment generation in an age of high oil prices and precarious domestic politics, the sector consisting of some 200 entities has since expanded to an estimated 600 000 employees in 2012 (Wing, 2013) Complaints of low skill levels, political employment, lack of competitiveness and over-staffing are widespread: by some estimates, 60% of staff are unneeded.

Morocco, a country with a population that is somewhat larger than the Iraq and comparable to Algeria, has considerably smaller SOE employment. As of 2008, the SOE sector included 716 public enterprises, which generated 12% of total added value in the Moroccan economy, invested twice as much as the central government, but only employed 125 000 individuals (IMF, 2010). SOEs have clearly been much less extensively used as employer of last resort.

The situation in Jordan and the GCC is similar. There is generally a more effective separation of (generous) surplus employment in the public sector from more performance-oriented employment in strategic SOEs, which offer better salary scales, but can also be more selective in their recruitment. Saudi Aramco, a far larger hydrocarbons producer than Algeria's Sonatrach, had a mere 56 000 employees in 2011. The exception to this rule appears to be Kuwait, where SOEs are generally subject to the same problems of overstaffing and less selective recruitment as the public sector at large. Over-employment and lack of performance management in SOEs can be even more detrimental to development than in the rest of the state apparatus if the goods and services at stake are strategic, if their production requires particular skills, and if they are meant to drive economic diversification and set a benchmark for the private sector.

Perhaps more important from a welfare perspective, SOE employment is an inefficient, and quite likely unfair, way of redistribution. It is discretionary, potentially subject to political manipulation and "lumpy" – while some citizens benefit from it, many others are altogether excluded from it. Not only do MENA public sector wages, although low outside of the GCC, on average still lie above those in the private sector, job security is also higher and work effort required often lower (IMF, 2006).[3] This creates potentially counterproductive incentives to acquire education that will maximize job acquisition and safety in the public sector rather than productivity in the private labour market, and siphons potentially good human resources out of the private economy where they might be most productive.

The latter problem is particularly acute in countries with small populations like the UAE. A number of Abu Dhabi based SOEs are reported to have engaged in bidding wars that have driven up salaries for nationals and further reduced incentives to seek private employment. In lower-income MENA countries, moreover, SOE employment has by and large been insufficient to provide for decent livelihood, forcing many employees to take secondary employment.

The distortive nature of SOE employment in the region has been increasingly recognised by governments, however the challenge of transitioning to fairer ways of providing social security has not yet been satisfactorily resolved. An approach that was been tried in Egypt entailed privatising SOEs and/or gradually allow them to wither away (a strategy of "reform by stealth") by not investing in their capital infrastructure and not replacing retired workers. Pursued in isolation, this strategy however has proved economically and politically costly.

During the privatisations of the early 2000s, many Egyptian SOEs were offered for sale before their restructuring was completed, resulting in a low

sale price that reflected the need for the buyer to invest in the company and assume its liabilities, including its workforce. As a result, the total stock of employees in SOEs has been reduced drastically from 1.3 million workers to 400 000 since the privatisation process began in 1991 until the mid-2000s (IMF [a], 2005). In combination with sometimes opaque privatization practices, this strategy has however often led to asset stripping in privatised companies and the destruction of employment – disappearing public sector jobs were not replaced by equivalent or more attractive private jobs.

The downsizing of the SOE sector in Egypt was not accompanied by the creation of a sufficient social security net that could have cushioned the disappearance of unproductive, but by Egyptian standards relatively well-paid employment, and could have guided dismissed employees into the acquisition of new skills. Uncompensated downsizing of SOEs in Egypt was arguably one of the factors contributing to the great unrest of 2011.

The relatively privileged status of SOE employment is one of the reasons that restructuring and privatisation of state-owned companies tends to be so fiercely protested in the labour force. The human resource implications of SOE restructuring are considerable and need to be addressed to allow for successful restructuring of underperforming state-owned companies in the MENA region. In this regard, the example of the social support measures introduced by the Turkish Privatisation Administration during the implementation of the privatisation programme, described in Box 4.1, are highly relevant. Further discussion on how to address this challenge in the region is a priority to render SOEs more competitive and to enable the restructuring of SOEs more generally.

Box 4.1. **Turkish Privatisation Social Support Project**

Turkey's privatisation process began in the mid-1980s and gathered speed in the 1990s. The government of Turkey has established the Privatisation Administration in 1994 as the entity responsible for executing its privatisation plans, designed as an element of a broader liberalisation drive. Since its establishment in 1984, progress in privatisation has been impressive, with the sale of state shares in 270 companies, 104 establishments, 22 plants, 8 toll motorways, 6 sea ports, 2 bridges, 1 service unit and 524 real estate lots.

In early 2000, it became clear that in order to guarantee the success of the privatisation plans, the risk of social unrest in the wake of further reform would need to be addressed. To this end, the Turkish government with the support of the World Bank designed the Privatisation Social Support Project with the objective of mitigating the negative social and economic impact of privatisation. The first phase of the project took place over the 2000-05 period.

Box 4.1. **Turkish Privatisation Social Support Project** *(cont.)*

The key components of the project included job loss compensation whereby displaced workers received severance payments, a labour redeployment programme aimed at offering a range of services to workers seeking alternative jobs, and a component focusing on evaluating the social impact of the reform programme (e.g. surveys to monitor the impact of privatisation in select communities, coping strategies by displaced workers, etc.). The project components were designed so as to provide comprehensive social support to workers.

Support was provided indirectly through a World Bank loan made to the Privatisation Administration that had significant budget constraints at that time, given that the Turkish economy experienced an economic crisis that culminated in 2001. Displaced workers received job loss compensation either in the form of regular severance or of targeted payments to encourage early retirement and to discourage workers from taking employment in other governmental entities.

Labour redeployment services included job counselling, on the job training, institutional training, temporary community involvement, and small business start-up counselling. A particular feature of labour redeployment is that labour unions have agreed to participate in the advisory committee to the programme. Another innovative feature was that funding was allocated in part based on territorial parameters such as the level of layoffs and general unemployment in a province and the poverty index in the province.

The programme was implemented in a difficult economic climate, where – not unlike in the MENA region – job creation was slow, population growth outpaced economic growth and labour regulations reduced the incentives to hire new workers. Nonetheless, it was widely perceived to be successful in reducing inefficiency of SOEs, facilitating the privatisation process and avoiding the possible resistance of labour to the latter. As a result, a second programme of similar nature was implemented by the Privatisation Administration from 2005-2010.

Source: World Bank (2006 and 2010), *Implementation Completion Report*, Privatisation Social Support Project, Human Development Sector Unit, Turkey Country Unit, Europe and Central Asia Region.

Examples of measures implemented as part of the Turkish Privatisation Social Support Project but also policy solutions from other privatisations should be considered by MENA governments dealing with employment concerns during privatisations. For instance, in Jordan, the privatisation of Royal Jordanian and the Jordan Phosphates Mining Company was also accompanied by voluntary retirement packages and schemes that allowed

workers to purchase shares in privatised companies at a discount and on credit (Mako, forthcoming).

There is great need for creative thinking on how to create and finance modern social safety nets and active labour market policies that can make SOE restructuring socially acceptable, be they unemployment assistance, unemployment insurance, cash grants or wage subsidies tied to private employment. International donors could play an important role in both technical assistance and funding of transitional arrangements in the post-revolutionary MENA countries.

The fiscal consequences of inefficient SOEs

Against the background of weak supervision, constrained management, public service and employment obligations mentioned above, it should come as no surprise that many MENA SOEs generate weak or negative revenues. The imposition of non-commercial objectives or price controls make profits hard to attain, while "soft" budget constraints can reduce managerial incentives to aim for profitability in the first place. It is therefore of little surprise that historically, public enterprise sectors, especially outside of the GCC, have by and large been an aggregate drain on the state fiscal resources. That being said, an evaluation of their fiscal impact is difficult to make as they are many quasi-fiscal channels of SOE support that go beyond direct fiscal transfers and do not directly show up in company balance sheets – and conversely, SOE activities can have positive developmental and economic externalities that are difficult to measure and not visible when looking at individual companies or the SOE sector in isolation.

Case studies and IMF country reports highlight that SOE losses as well as the resulting costs to governments have typically been higher on average in MENA than in other world regions. That being said, the World Bank's "Bureaucrats in Business" data base indicates that governments' net fiscal contribution to SOEs has tended to decrease from the early 1980s on, if only because of the shrinking size of the sector in many economies.

The World Bank data end in 1991, and further information is patchy and not easily comparable across countries. But even if aggregate, comparable profitability data on MENA SOE sectors was available, it would have to be treated with caution, as the real cost that SOEs impose on the government and national economy are not always obvious, and often not featured on either company books or in national budget figures. For a variety of reasons, there can be a huge difference between a company balance sheet and a company's net fiscal and macro-economic impact. These differences can be relatively clear when SOEs are directly subsidised through transfers from government, which is the most straightforward and easiest to detect indicator of fiscal costs.

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However, there are several channels through which hidden costs to the government budget and the national economy can occur. For instance, SOEs are often provided loans from public banks that are often not repaid and eventually have to be forgiven to repair these banks' balance sheets (sometimes in preparation of privatisation, as was the case in Egypt). These loans are often provided to SOEs at below-market rates. For instance, the Saudi Public Investment Fund provides large, low-cost loans to public enterprises for strategic projects. In countries where public banks play a significant role in the total financial system, preferential lending to SOEs has led to crowding out of lending to private enterprises, with negative macroeconomic effects.

Loans to SOEs can also be indirectly subsidised through implicit or explicit sovereign backing of SOEs, a mechanism through which SOEs in the Gulf often achieve very low yields even with private banks that lie below the rates that large, well-established private groups are provided with. Sovereign guarantees however can be a burden on the fiscal credibility of a government (thereby increasing its borrowing costs) and, in case of default, can create a direct liability (an issue that Dubai had to contend with in the wake of its financial crises in 2009-10). They can also crowd out private sector lending even in countries with large private banking systems, such as the UAE, where SOE credit needs have been sizeable.

SOEs can also incur debt to other SOEs that goes uncollected, as has been the case with Bahrain's loss-making Gulf Air, which had incurred debt of 173 million USD to Bahrain's national oil company BAPCO by summer 2012. In the Iraqi case, SOEs have apparently also been ordered to preferentially transact with other SOEs, which can amount to a quasi-subsidy of potentially large fiscal importance (Wing, 2013). In addition to subsidised or free credit, SOEs can receive indirect subsidies through state purchasing of their goods and services at above-market prices. For instance, the Kuwaiti government is obliged to procure all business flight tickets for its staff only through Kuwait Airways, which are paid at full fare.

Other quasi-fiscal subsidies include inputs provided to SOEs below market prices, which can impose high opportunity costs on governments and national economies. Notable examples include the provision of cheap kerosene for national airlines (e.g. Kuwait Air and Saudi Airlines) and the supply of cheap gas and electricity for industrial companies (especially in heavy industry). In resource-rich countries, these inputs are themselves often provided by other SOEs, whose reduced profit in turn impacts government revenue. Preferential inputs also include free or low-price land, real estate and in some cases – notably that of military-operated SOEs in Egypt – the provision of free labour by military conscripts.

The above processes make coherent accounting of the fiscal impact of SOEs very difficult – all the more so when prices are controlled and inputs (including loans and capital) rationed through non-market mechanisms. We are not aware of any coherent, consolidated attempt in the region to achieve such accounting. We do however believe that such processes explain some of the questionable figures provided in national sources – such as the publicly reported claims that the (non-oil) Syrian public enterprise sector from 2003 to 2007 has consistently generated revenues that are at least three times higher than the state transfers to the sector (IMF, 2007), amounting to 10-25% of total government income as compared to transfers amounting to 4-10% (still a substantial share when compared to the 1-2% common in Morocco, a country with a smaller SOE sector) (IMF, 2003; IMF, 2004; IMF [b], 2005).[4]

Direct transfers are generally preferable to indirect support through quasi-fiscal operations such as subsidised inputs or concessionary loans. To make clear cost accounting easier, Algeria announced a plan to partially replace public bank loans to SOEs with government subsidies in 2005, a step welcomed by the IMF as it was expected to free credit for the private sector (IMF [c], 2005). Total credit to public enterprises declined during 2005-2006; the share of credit to the private sector increased from 43% in 2003 to 53% in 2006 (IMF [b], 2008). After the global financial crisis, however, Algeria again stepped up its support for SOEs, with subsidies to SOEs increasing from 13% of total spending in 2009 to an expected 18% in 2013, corresponding to an increase by 120% in absolute terms (IMF [b], 2013).[5]

Credit statistics for Syria look similar to the Algerian ones, with private sector loans overtaking SOE loans in the mid-2000s, but SOE loans (mostly provided by public banks) nonetheless continuing to grow at a rapid pace until the end of the decade. On the other hand, the picture in Jordan is drastically different. Credit to SOE constitutes a very small share of total credit, which in any case is mostly provided by private banks.[6]

Similarly, SOE debt in Morocco amounted to between 13 and 18% of GDP in 2006-08 (of which some share was probably held internationally), while total domestic credit to the economy reached between 57% and 78% of GDP (IMF [b], 2005; IMF, 2010; IMF [b], 2011). Even in the Gulf, the sheer scale of SOE investments can lead to macro-economic distortions and large quasi-fiscal burdens, as Box 4.2 illustrates.

The scale of the SOE sector is relatively smaller in other GCC countries, but operations such as the provision of free or very cheap utility services, cheap loans, sovereign (quasi-) guarantees and inter-SOE transactions at non-market prices are nonetheless significant. Individual companies can incur significant losses. For example, Bahrain's Gulf Air has been incurring heavy losses, amounting to 2.5% of the country's GDP and about 9% of total

Box 4.2. **Emirati SOEs and the financial crisis**

In Dubai, home to some very successful SOEs that have defined the economic landscape of the Emirate, direct government revenue from SOE profits has fluctuated between 4 and 14% of total government revenue over the years. Annual SOE dividends to the government have never exceeded a total of 800 million USD, while Dubai World's debt alone amounted to 59 billion USD in 2009, forcing the Dubai government to borrow 10 billion USD from Abu Dhabi. This has substantially increased Dubai's international financing costs due to widening credit spreads.

While Abu Dhabi never defaulted on any debt, Fitch estimates that continuing budget support to local SOEs averaged over 10% of GDP in 2009-11 (and more than 15% of non-oil GDP) – possibly a bigger share than anywhere else in the region, with Mubadala probably accounting for a significant part. In 2012, Abu Dhabi declared officially which government-related entities enjoy sovereign backing and which do not, contributing to transparency but not necessarily alleviating distortions in the credit market. According to the IMF, in March 2012 the overall debt of UAE SOEs stood at 185 billion USD, or 51% of the country's 2011 GDP, with Abu Dhabi accounting for over 54% of the total.

While the indirect benefits of Dubai's SOE strategy for the country's broader economic development are beyond dispute, even in this paragon of success, the direct contribution of SOEs to state income has been comparatively modest and the fiscal costs at times of crisis potentially huge. In part to address this issue, the government of Abu Dhabi has decided to require all local SOEs to seek explicit sovereign backing from the Executive Council before issuing debt. A number of UAE based SOEs have issued conventional debt and sukuk in recent months and the shift towards bond based as opposed to equity based financing by SOEs is poised to continue.

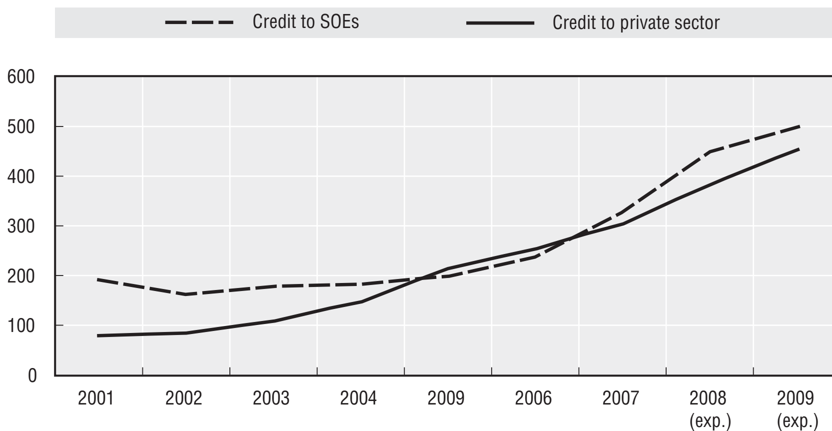
Source: Various IMF Article IV reports on the UAE, Fitch country reports.

government spending in 2009, the year of its worst performance (Centre for Aviation, 2010, 2012; IMF [d], 2012).

The opportunity cost of Saudi Arabia's provision of cheap gas, water and transport fuel through various public enterprises has been estimated at 10% of the country's GDP (Hodson, 2011). Most economists concur that the current subsidisation of petrochemical products in Saudi Arabia and other Gulf countries is economically sub-optimal and that more targeted subsidies are needed to reach the poor. A number of policy alternatives can be considered to better target or phase out existing subsidies, including for example selling feedstock at closer to world prices and using incremental revenues to support SME development.

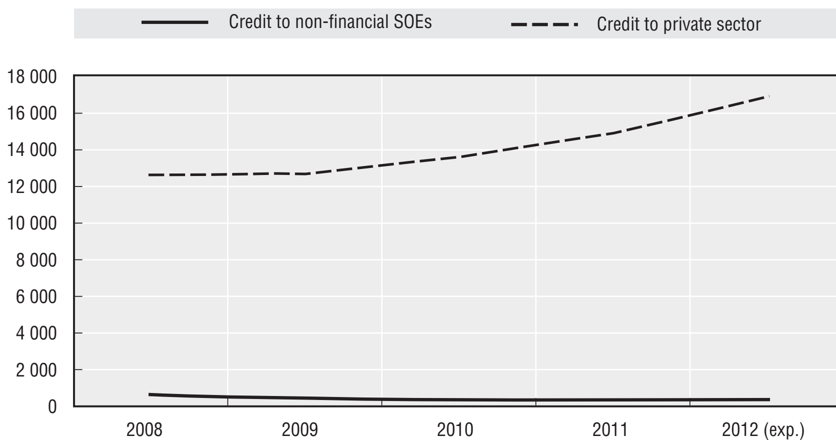
SOEs weigh especially heavily on budgets of governments in oil-importing countries. In Lebanon, years of under-investment and governance problems in the national electricity company (EDL) have cost the government over 1.5 billion USD in subsidies annually and have in addition affected the competitiveness of the overall economy, especially the energy-intensive manufacturing sector (IMF, 2012). In Turkey, the government continues to fiscally support its SOE sector, but on a relatively modest scale of around 0.5% of GDP (albeit up from around 0.3% before the global financial crisis). At the same time, the sector has produced aggregate profits for most of the last decade, indicating that the government, at least in aggregate, is not throwing "good money after bad" (refer to Figure 4.2).

Figure 4.2. **Syrian bank claims (in billion Syrian pounds)**



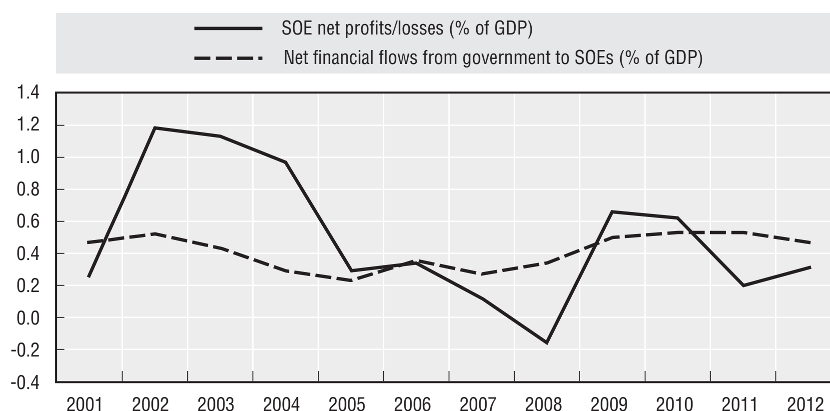
Source: IMF, Article IV reports on Syria.

Figure 4.3. **Jordanian bank claims (in million Jordanian dinars)**



Source: IMF, various Article IV country reports on Jordan.

Figure 4.4. **Aggregrate profits of and fiscal support for the Turkish SOE sector**



Source: Turkish Treasury.

The challenges of putting a price on SOEs' non-fiscal contributions

Except for few isolated cases, the fiscal contribution of non-hydrocarbon SOEs in the MENA region is modest. On the other hand, SOEs have been a fiscal burden for many, if not all governments of the region. In preceding sections, this report has analysed many factors that can cause SOEs to make losses: fragmented and ineffectual public supervision, lack of managerial autonomy, soft budget constraints and a wide variety of non-commercial objectives, including employment generation and the provision of cheap goods and services to strategic clients or the general public – the latter of which are often categorized as "quasi-fiscal activities" as they function analogous to subsidies.

All the above can negatively impact the balance sheets of SOEs – but these are often not the best guide to their net fiscal effect of SOE operations. We have reviewed a variety of mechanisms through which governments can support SOEs without engaging in direct fiscal transfers, which can decrease losses (or increase profits) of SOEs but in turn generate negative fiscal effects for governments. Such indirect losses might in many cases be significantly larger than the direct SOE losses recorded in company accounts and are much harder to measure.

Some of the losses of SOEs as well as their indirect fiscal costs might be justified by broader developmental, social and strategic objectives pursued through their activities, however such positive externalities are not reflected in company balance sheets. In that case, objectives that are not directly related to the commercial well-being of a given SOE need to be made explicit

and their value determined to allow for clearer accounting and cost-benefit estimations. Perhaps imposing non-commercial objectives on specific SOEs is indeed the cheapest way to deliver on employment generation, public service provision or regional development. At times, SOEs are needed to provide critical services and develop infrastructure.

At a minimum, a concrete price needs to be put on these objectives and alternative ways of achieving them need to be explicitly considered. In some cases for example, a "least subsidy tender" that makes fiscal costs explicit and allows for competition between private providers in delivering a specific public service might deliver better results than a public monopoly. Governments in the region have yet to undertake a systematic determination of the total value of SOE outputs and their indirect costs. With budgets in oil-importing MENA countries under great stress, and social demands growing in the wake of recent unrest in the region, this issue is more relevant than ever. Governments need to seek the most effective way to deliver on their social objectives, at the same time generating public awareness of the direct and indirect cost of "business as usual". In many ways, the region needs a more equitable social contract, and making fiscal costs and benefits of service delivery through SOEs more explicit is an important prerequisite for the negotiation of this contract.

SOEs and effective competition

Context

Owing to government interference in SOE activities, they may not compete on a level-playing field with private companies. Given that they operate in a range of key sectors where their operations may have an important socio-economic impact, this is a pressing issue. *The OECD Guidelines on Corporate Governance of SOEs* recommend that all obligations placed on government companies must be clearly prescribed by legislation or regulation and that these companies must operate on a level playing field, including with respect to access to finance.

That said, the Guidelines recognise that in some cases, SOEs are expected to fulfil special responsibilities and obligations for social and public policy purposes that may well go beyond the generally accepted norm in commercial activities (OECD, 2006). The case studies above have illustrated a variety of circumstances where the activities of commercial SOEs exceed their stated objectives. In the majority of cases, SOEs are compensated for this directly or indirectly, which is in line with practices in other regions. In a minority of countries, public services are funded through user charges that are directly factored into the cost structure.

While the practice of compensating SOEs for unprofitable public service obligations is common, the structure of this compensation needs to ensure that it does not negatively affect competitive neutrality, including finance, tax, regulatory, and debt neutrality (OECD, 2012b). In most countries, elements of competitive neutrality have been dealt with through competition law and policies (OECD, 2011c). In case of EU member states, specific provisions of EU law bearing on competitive neutrality apply to all undertakings regardless of ownership, including private companies entrusted with public service obligations and companies benefitting from exclusive rights.

Despite the fact that many SOEs in the MENA region operate in commercial sectors, they have historically not been subject to level-playing field competition from the private sector and have often enjoyed implicit or explicit support from the government. As explored by Steffen Hertog, in a number of instances, government support to SOEs was essential to the establishment of heavy industry or other enterprises of a scale too significant for the private sector to undertake alone (OECD, 2012a). However, in an effort to encourage competition in order to improve the provision of services to the public, a number of sectors and, by corollary, SOEs operating in monopolistic or oligopolistic frameworks, have been reformed.

Attaining competitive neutrality is an important policy objective in the MENA region not only to improve economic efficiency and fairness of competition between SOEs and private companies, but also for the future development of the private sector. Insofar as key SOEs operate in sectors with relatively high barriers to entry, they face competition only from large local conglomerates/merchant families and potentially other large SOEs or foreign competitors. In this context, it is clear that fair competition is instrumental both to developing the local private sector and to attracting foreign investment to the region.

Competition frameworks

The field of competition law in the MENA region has only recently begun to develop. Jordan is the first Arab country to have adopted competition legislation in 2002. In other countries such as Syria and Algeria, competition legislation and authorities were introduced very recently, and there are still a number of countries in the region such as Oman[7] with no competition law (although elements are addressed tangentially in other decrees and regulations). In other countries such as Saudi Arabia, a competition commission exists but is relatively inactive. As a result of this nascent level of legal and institutional development in the area of competition, little is known about the frameworks within which state-owned enterprises contend with private sector entities.

Even where competition is regulated, not all SOEs are included in the remit of the relevant laws and sometimes they are even explicitly excluded. In some instances, the relevant authorities are prevented from launching investigations into SOE practices because some companies or sectors are explicitly not subject to the competition legislation. In Egypt, for example, public utilities managed by the state are not subject to the Competition Law, while private utilities may apply to the Egyptian Competition Authority for total or a partial exemption (OECD, 2011b).[8]

SOEs are explicitly not addressed by competition frameworks in Gulf countries although some of these countries are reported to be in the process of introducing competition legislation. In addition, some SOEs organised as statutory corporations by virtue of a special decree of the government can be made explicitly exempt from the competition law, even if other SOEs are technically subject to it. This may have limited implications in reality since companies in strategic sectors such as hydrocarbons and defence operate in monopolistic sectors with no plans to change this structure.

That said, even in jurisdictions where SOEs are covered by the relevant competition law, competition authorities are usually only empowered to prevent price gauging, cartel formation and deal with market access issues. It is rare for the competition law to include provisions covering issues such as artificially low pricing by SOEs, except where manifest predatory strategies can be proven. Furthermore, even in sectors where competition legislation formally applies, investigation of SOEs may be practically difficult to orchestrate.

The difficulty of enforcing competition laws on SOEs in the MENA region is manifold. First, the authority for opening an investigation into an SOE's behaviour often lies with parties that might have little incentive to investigate anti-competitive practices of government enterprises. In Egypt, a ministerial request is often required for the Competition Authority to launch an investigation and ministers, who are also in most cases official "owners" of SOEs, arguably do not face strong incentives to ensure that these companies compete with their private competitors on a level playing field.[9] Other complications arise from lack of clarity in the legislation. For instance, the nature of state aids is not commonly addressed in detail, making the application of legislation challenging for the regulator.

A more fundamental issue perhaps is that competition authorities are relatively new (or still absent in some countries[10]) and hence their experience in investigating SOEs is often limited. Furthermore, the delineation of oversight authority between competition authorities and sectoral regulators has not always been made clear, resulting in lacking or slow investigations and prosecutions. To address this challenge, the Egyptian Competition Authority filed a claim before the State Council in order to settle a dispute regarding the scope of authority

between itself and the National Telecommunication Regulatory Authority (OECD, 2011b). Generally speaking, entities with formal responsibility for many sectors have struggled to establish their authority in MENA countries since their work has tended to encroach on jurisdictions of line agencies and sectoral regulators.

The signing of MOUs between competition regulators and sectoral regulators, as is the case in the telecom sector in Egypt but also in Jordan, appears to have improved enforcement more generally and in cases involving SOEs more specifically. Alternatively, the competition regulator can be explicitly mandated to deal with competition issues in all sectors as it is the case in Algeria. This is technically more straightforward in industries that do not have sectoral regulators. Indeed, few countries in the region have established sectoral regulators beyond aviation, banking, telecommunications and securities trading industries. Morocco stands out as a positive example as it also has authorities dealing with regulation of audio-visual communication, insurance and other sectors, although only one of them has the exclusive right to deal with competition issues in the sector (World Trade Organisation, 2009).[11]

Private and public monopolies

A number of strategic SOEs in the region operate in monopolistic sectors and the appetite to introduce competition in some sectors such as electricity or oil production has been limited. In addition, given that a number of SOEs provide direct services to the population and often at below market price or even below cost, their privatisation has been contested by the public. As a result of these and other considerations, policy makers in the region have recently demonstrated more interest in PPPs as opposed to outright privatisations. PPPs attract the interest of policy makers due their cost-sharing approach, the ability to access technical expertise, and the option for governments to "outsource" performance-related responsibilities.

At the same time, the implementation record of PPPs in the Middle East has been uneven at best. A key challenge in this regard is that the know-how in negotiating such contracts in the public sector is still developing and governments have stalled in introducing PPP regulatory frameworks. In Lebanon for example, while the government has delayed the introduction of a PPP law, considerable controversy has surrounded existing PPPs, including the contract to operate the famous Jeita Grotto and a waste disposal plant in Saida.

Even when properly structured, private sector participation has not always helped to address the provision of essential services. For instance, in the water sector, private sector participation is significant in a number of countries (e.g. Algeria, Morocco, Tunisia and Saudi Arabia).[12] Despite this, steady access to drinking water remains a source of contention, even in

wealthier countries of the region such as Saudi Arabia. The understanding of how public sector involvement can successfully co-exist with PPP arrangements to address needs for essential services is still evolving.

While PPPs might not have enabled governments to disassociate themselves from performance-related issues, they have to some extent been successful in insulating them for backlash resulting from price increases on basic services. However, the success of this strategy in the post-Arab Spring Middle East is doubtful. In addition, experts express apprehension that full or partial transfer of key state assets to the private sector, whether in the form of PPPs (which are typically structured as long term arrangements) or outright privatisations raises the risk of creating private monopolies to replace public ones.

While private monopolies may technically be dealt with more effectively by competition regulators for reasons that will be explored below, a common view in the region is that they are more dangerous for the public good that state-operated monopolies. While private monopolies could in principle be "protected" by high level principals much like public ones, they may be freer to define their strategy (i.e. price, distribution, etc.) without the oversight of regulatory or state audit bodies. This is an especially valid concern for companies that are not listed and hence not subject to public disclosure requirements, independent audit and other accountability mechanisms. The efficiency of public monopolies also remains an issue to be addressed from competition and public service delivery angles.

The role of sectoral regulators

The telecommunications, banking, transport and electricity sectors are examples of industries where the establishment of a sectoral regulator has allowed the separation of regulatory from commercial activities. In these sectors, even in the absence of powerful competition authorities, sectoral regulators have been relatively successful in establishing frameworks that promote fair competition. The telecommunications sector in particular provides a number of positive examples of thriving competition between state-owned, private and foreign competitors (the latter in turn also being both private and state-owned).[13]

Countries with more advanced telecom regimes in the region such as Jordan or Morocco have started reforming their SOE sectors in the mid-1990s by reviewing regulatory frameworks and allowing for greater competition. Consumers were the direct beneficiaries of these measures, owing to the emergence of a choice of providers, which exerted a downward pressure on prices and resulted in impressive increases in the penetration of mobile services. For example, Morocco's mobile penetration increased from just over 1% in 1999 to over 40% in 2005 (El-Darwiche et al., 2007).[14] In Bahrain, where the telecommunications sectoral regulator was established a decade ago,

competition between the local SOE (Batelco) and its competitors has been intensive (see Box 4.3).

Box 4.3. **The role of TRA in creating competition in Bahrain**

The government of Bahrain established the national telecommunications company (BATELCO) in 1981 as the sole provider of national telecommunication services, with the state as the principal shareholder. For the next two decades, BATELCO held a complete monopoly on the local telecommunications market. Starting in 2000, the government began liberalising a number of economic sectors, the first of which was the telecommunications sector. The Telecommunications Regulatory Authority (TRA) was established in 2002 and rapidly worked to introduce greater competition in the sector, awarding new licenses to other providers (MTC-Vodafone, Zain, Viva Bahrain and Mena Telecom). The TRA is headed by a board of directors appointed by royal decree for a four year term based on a proposal from the Council of Ministers.

BATELCO remains majority state-owned by the Mumtalakat (Bahrain's sovereign wealth fund) and the Social Security Organisation , while the nature of other shareholders is not entirely clear (i.e. a 20% stake is owned through a Cayman Islands entity, as per Batelco's annual report). The government hence has a direct stake in the profitability of the company and might theoretically not be motivated to ensure that a level playing field with foreign competitors exists. In practice, the TRA is one of the most transparent sectoral regulators in the region, with true mandate to create a level playing field in the sector.

The TRA conducts public consultations where it solicits comments of all operators on the existence of a level playing field and seeks to ensure that no incumbent benefits from its position (see for example, Strategic and Retail Market Overview conducted in 2007). It extensively circulates drafts of new regulations. In addition, the regulator has on occasion taken action against the interest of BATELCO. For example, the TRA issued a decision against the interests of BATELCO in September 2009 concerning its dominance in the broadband market.

When benchmarked with governance practices of other Bahraini SOEs or those of its competitors, BATELCO practices and processes compare positively. Its board has adopted its own corporate governance guidelines based on the recommendations of the Central Bank and the Ministry of Industry and Commerce and the board of BATELCO are responsible for their review every two years. The annual report of the company provides extensive details on the structure and operations of its board, board evaluations and details of AGM decisions and policies on related party transactions which seem to indicate practices which remain relatively rare in other SOEs in the GCC and the MENA region more generally.

Box 4.3. **The role of TRA in enforcing competition in Bahrain** *(cont.)*

One interesting question to consider is to what extent the advanced governance practices of BATELCO are due to the regulations of the sectoral regulator and to what extent they mirror other developments such as the need to remain competitive with private sector incumbents. In addition, the role of Mumtalakat in improving its governance practices also merits further analysis. Mumtalakat has been at the forefront of promoting good governance practices in its investee companies, including more recently the publication of a manual for the directors it nominates on boards.

Source: Batelco and TRA websites.

In Bahrain, and also in Qatar, telecom regulators have issued decisions against the interest of state-owned companies. In Qatar, the Supreme Council for Information and Communications Technology has for example issued a ruling in 2010 against the partially state-owned Qtel when Vodaphone Qatar lodged a complaint against the former for misleading advertising (OECD, 2012a). Not all telecom regulators in the Gulf have been as active in encouraging the liberalisation of and competition within the sector. Indeed, a recent WTO review of the UAE noted that competition in the telecoms sector remains limited and prices of services remain high, despite the introduction of a sectoral regulator and the admission of a second telecoms operator (i.e. Du) to the market in 2006. Considering that both Etisalat and Du are state-owned (with 60% and 40% ownership, respectively) and pay significant royalties to the government, the state may not have the incentive to admit private sector operators to the market.

Ultimately, the determining factor to the success and the relative power of sectoral and competition regulators is their operational and financial independence. For instance, in Tunisia, the budget of the Competition Council is approved by the Parliament as opposed to a line ministry, and the Council submits its annual report to the President, unlike other countries where competition regulators report to a line minister. The budgetary independence of sectoral regulators is lacking in some countries such as Morocco, Lebanon and Jordan,[15] with the result that their effectiveness has also suffered. Box 4.4 explores the example of the Lebanese Telecommunications Regulatory Authority and its role in ensuring effective competition in the sector.

Due to the lack of budgetary independence of competition and sectoral authorities in many countries of the region, competition enforcement is reportedly characterized by political interference, with final decisions often rendered by a Minister (Mehta, Udai S. and Rijit Sengupta, 2012). Even where decisions reside with senior staff of the competition regulator, this only

Box 4.4. **Towards an independent sectoral telecom regulator in Lebanon**

The Lebanese Telecommunications Regulatory Agency (TRA) has been operational since 2007 (officially created by law in 2002), but it remains financially and operationally dependent on the Minister of Telecommunications and is reported to suffer from political interference in its operations. Despite longstanding discussions about liberalising the telecommunications sector and opening it up to competition, the structure of the industry remains largely unchanged.

Ogero, the state-owned fixed line operator, is managed directly by the Ministry of Telecoms, which is the same body that issues contracts to it. At the same time, the creation of a joint stock company Liban Telecom which would effectively corporatise services currently performed directly by the Ministry and which could be eventually privatised, has not materialised.

This arrangement effectively puts the regulator, which is not independent from the Ministry, in a position where it has to regulate services provided by the Ministry. Political stalemate between the two entities reached its peak when the Ministry kept the regulator's staff unpaid for four months in 2011.

The Ministry is reported to have the powers to issue permits for all equipment imports and selling Internet capacity in partnership with the state-owned Ogero, thereby putting private operators at a clear competitive disadvantage. It is reported that the Ministry purchases 2 Mbps for less than 30 USD and sells it to private service providers for 3 000 USD. Such practices have resulted in a competitive advantage for Ogero which has gained 80% of the DSL market. A similar situation has developed in the mobile telecom sector whereby Alfa and MTC (both state-owned operators) are provided advantages in the form of subsidised antenna rental space, electricity costs and lower taxes.

This clearly impacts the emergence of a healthy competition in the telecom sector in Lebanon and ultimately explains why telecommunications services (i.e. mobile, Internet, etc.) are among the most expensive and lowest quality in the region. Indeed, the prices of mobile telecommunications in Lebanon are reported to be the highest in the MENA region and the coverage is poor. To address the poor quality of the network, it is not uncommon for subscribers to have contracts with both providers. Given income levels in Lebanon, this implies that the cost of mobile communications remains prohibitive for a large segment of the population.

Source: Tarabay, Imad (2010), "Seeking A Fair Deal for Private Sector Providers for 3G Services", *Executive Magazine*, March; author interviews.

partially alleviates the political pressure since the appointment of senior representatives of these entities is often made by the relevant minister. The growing independence of state audit bodies for example could serve as a positive model that might be leveraged as a conceptual framework for future development of competition and sectoral regulators in the region.

Subsidies and enforcement

Due to the abovementioned constrains, the record of enforcement by sectoral regulators or competition authorities against SOEs is limited, even though it is generally recognised that competition problems often arise in sectors where SOEs are present. For instance, the OECD competition policy review of Egypt noted that competition-related problems were most pronounced in sectors where there is strong state control and not much scope for the Competition Authority to act (OECD, 2011b). Although detailed country data on this issue is not available, Table 4.1 highlights cases known to the authors of competition-related investigations against SOEs.

Due to the low quality of disclosure by some SOEs, especially those that are not listed, it is often difficult to determine if SOEs indeed benefit from direct and indirect subsidies. This is exacerbated by the fact that subsidies are not generally budgeted, instead occurring through ad hoc government transfers.[16] The only possible exception to this is the Moroccan contractualisation programme whereby SOE social objectives and their estimated cost are agreed upon in advance and hence do not occur through irregular budgeting procedures (OECD, 2012a). This mechanism allows for SOEs to be compensated for their extra-commercial functions and hence compete on a level playing field against their competitors.

For SOEs not compensated through direct transfers, proving that they benefit from favourable treatment may be much more difficult given the multitude of ways that they can be indirectly subsidised or excused from the application of requirements that apply to private companies. Such exemptions might be especially sensitive if applied to national SOEs operating in an international context, where national governments may have an interest in supporting a local incumbent "against" a foreign or state-owned competitor. The airline industry in the Gulf is perhaps the most evident example of this, in which a number of countries have sought to establish their state-owned companies as prime choice for transport to the Gulf and on long-range routes transiting through the Gulf.

While the Kuwaiti and Saudi governments may be eventually looking to privatise their non-performing national carriers, for the governments of Dubai, Abu Dhabi and Qatar, the success of national airline carriers are pivotal for their ability to position themselves as a hub for international transport and

Table 4.1. **Investigations into anti-competitive behaviour by MENA SOEs**

	Date	Nature of case	Outcome
Algeria	2003	Abuse of dominance by Algérie Télécom	The Authority for the Regulation of Post and Telecommunications forced Algérie Télécom to end discriminatory practices against Orascom Telecom
Algeria	2000	Abuse of dominance by the Algerian Company of Trade Shows and Expositions (SAFEX)	The Competition Council reached an agreement with SAFEX which required the company to cease its anti-competitive business practices
Bahrain	2009	Abuse of dominance by Bahrain Telecommunications Company (Batelco)	The Telecommunications Regulatory Authority fined Batelco for failing to allow other operators equal access to cable systems. The fine was reduced in 2012 after a long litigation process
Egypt	2011	Abuse of dominance by Alexandria Portland Cement Company	The Egyptian Competition Authority found that the company did not have a dominant position in the market
Egypt	2009	Abuse of dominant position by Sinai Manganese Company and Gipsina	The Egyptian Competition Authority found that despite high market share, these companies did not have sufficiently dominant position in the market to affect production volumes and price levels
Egypt	2009	Abuse of dominant position by Eastern Company (tobacco)	The Egyptian Competition Authority did not find a violation of the competition law and closed the file
Egypt	2008	Participation of National Cement Company in a price-fixing cartel in the cement market	The Egyptian Competition Authority referred the case to the courts where 20 defendants (managers of private cement companies and state-owned National Cement Company) were fined 10 million Egyptian Pounds each
Jordan	2007	Alliance of Royal Jordanian Airlines with four foreign companies with the objective of coordinating market practices	The Competition Directorate recommended that the case should remain under scrutiny to ensure that competition law is respected
Tunisia	2010-11	Abuse of dominant position by Tunisie Télécom	Decision not available
Tunisia	2004-05	Participation of all Tunisian banks (including state-owned banks) in a price fixing cartel	The Competition Board ordered the practice of fixing cheque commissions to be halted and imposed penalties
Morocco	2001	Abuse of dominant position by Maroc Telecom	The National Agency for the Regulation of Telecommunications ruled that favouring customers calling on phones of their mobile phone operator was an abuse of a dominant position and forced Maroc Telecom to end the scheme
Qatar	2011	Abuse of dominant position by Qtel	The telecom regulator has ordered Qtel to shut down its mobile telephony services provided through Virgin Mobile, amongst others due to anti-competitive conduct

Source: Moritz Schmoll, based on review of competition agencies websites and newspaper articles.

tourism. As a result of intense competition between them and also with European and North American carriers, there has been an intense debate about the supposed subsidisation of these companies, an allegation strongly

denied. Box 4.5 explores the allegations and counter-arguments of Emirates regarding the existence of a level playing field between the airline and its foreign competitors.

Box 4.5. **Emirates Airlines: A level playing field?**

Emirates Airlines was established in 1985 with the support of the Dubai royal family, at first as a reaction to the lack of services by regional airline Gulf Air to and from Dubai. At that time, the airline received 10 million USD in start-up seed capital and benefitted from 88 million USD in infrastructure. Since then, it has expanded rapidly, owing to aggressive marketing and the positioning of Dubai as a hub for long haul travel, similarly to the model adopted by Singapore. It now reaches 128 destinations and has been consistently profitable since its inception, achieving profits of 630 million USD in 2011.

Considering the rapid growth of Emirates Airlines, concerns that its international expansion is supported by generous subsidies or other benefits accorded by the Dubai government have been voiced by Emirates' competitors. Responding to these allegations, Emirates has recently publicly outlined its position on the issue. Emirates disputes the view that it benefits from market distorting subsidies either in terms of preferential fuel cost, landing and airport usage fees, or cheap labour.

Fuel costs accounted for over 34% if Emirates' total operating costs – similar to the share for other international airlines – and the company argues that it does not benefit from subsidies. That said, despite the fact that Dubai is not a large oil producer per se, fuel prices in the Gulf are significantly lower than those of European or American carriers where taxes on fuel significantly increase its cost. Foreign airlines refueling in Dubai benefit from the same price but pay a higher price when refueling in Europe or other destinations where fuel costs are higher.

Emirates also confirms that its funding, totaling some 26 billion USD over the past 15 years, was accessed on a commercial basis and that the company does not benefit from additional funding from the government of Dubai or its entities. It points out that although it is not publicly traded, it publishes annual financial reports in accordance with IFRS, which are audited by an independent auditor according to the IAS.

The company argues that its labour costs are substantial as a result of generous compensation packages and relocation allowances. The fact that labour is unionised in other airlines with which Emirates competes may indeed put the latter in a unfavourable position vis-à-vis carriers whose labour force is not unionised. Further, the fact that local companies in the UAE do not have to pay corporate taxes would seem to put Emirates in favourable position as compared with its competitors, at least in this respect.

Source: Emirates Airlines (2012), "Airlines and Subsidy: Our Position", *www.emirates.com*.

The case study of Emirates Airlines highlights some of the key reasons for the establishment of SOEs in the Gulf and their ability to contribute to the overall economic competitiveness strategy of local economies. Especially in the Gulf, state ownership was initially seen as necessary to undertake the scale of capital investments needed. It continued given that in many cases the companies in question became profitable and strategic for the overall economic development. The prevailing concern with these SOEs, which now often operate as multinational companies, is that that they may be operating at a real or perceived competitive advantage to other private operators and hence may face growing protectionism.

The story of the development of Turkish Airlines, described below, highlights the difference in approaches of governments trying to attain the same objective: establishing a national air carrier that would contribute to image building and attract business commuters and tourists. Unlike Emirates, which is fully government-owned and whose governance arrangements remain quite opaque as discussed above (unlike its financial reporting), governance reforms realised through partial privatisation of Turkish Airlines are a key factor explaining the success of the company, which is now subject to rigorous competition on both national and international routes.

Since its shares are listed on the local stock market, Turkish Airlines has been subject to the rules of the Capital Markets Board of Turkey. These require it to publish, as any other public company, a corporate governance compliance report as a part of its annual report and provide disclosure to investors through the Public Disclosure Platform which allows them to obtain up-to-date information about the company on a timely basis. Since its listing, Turkish Airlines has had to make significant changes to its governance structure such as separating the positions of board chairman and CEO. These changes are seen as having contributed to its success in recent years, as explored in Box 4.6.

Box 4.6. **Turkish Airlines: Competitiveness through better governance**

The Turkish Airlines Corporation (THY), founded in 1933 under the name State Airlines Enterprise to promote the aviation sector in Turkey, is still the national air carrier. In 1984, the company was re-organized as a state-owned enterprise (SOE) and included in the country's privatisation programme. Between 1990 and 2006, THY was partly privatised through public offerings and as of December 2012, the state's share in the company declined to 49%, although it still keeps a golden share which grants it special management and approval rights in order to protect Turkey's interests related to national security and the economy.

Box 4.6. **Turkish Airlines: Competitiveness through better governance** *(cont.)*

Initially, Turkish Airlines operated as a monopoly in the domestic market, while competing with foreign airlines in the international market. Though the liberalisation of the civil aviation sector started in 1983, THY continued to operate as a monopoly in domestic market for decades until the private sector accumulated enough financial sources. In 2003, the Ministry of Transport gave permission to privately owned airlines to operate in the domestic market and soon private sector participation increased substantially.

As a result of the liberalisation of the sector, the influx of private capital and improvements in THY, the number of destinations increased, prices declined and market growth rates reached unprecedented levels. The total number of passengers for both domestic and international flights increased from 34 million in 2003 to 62 million in 2006 and 117 million in 2011. The total number of domestic registered aircrafts increased from 150 in 2003 to 250 in 2006 and 347 in 2011. Also, the total number of destinations increased from 103 in 2003 to 131 in 2006 and 200 in 2011. With the effect of intensified competition, the market share of THY had fallen in 2011 to 50% in the domestic passenger market and 30% in the international market.

In this new competitive environment, THY has adjusted its strategies and objectives. Its mission was redefined to be a leading European airline and an active global player. As of December 2012, with 202 aircrafts in the fleet and flying more than 200 destinations, THY offers one of the most extensive flight networks in the world. Moreover, THY has become a good example for implementing corporate governance principles in a publicly owned company. Since its shares are listed in the stock market, THY has been following the rules of the Capital Markets Board of Turkey which are based on international corporate governance principles, transparency and accountability.

As a result of these achievements, the gross sales of the company reached 12 billion TL in 2011 (6.6 billion USD), up from 4 billion TL in 2006 (2.8 billion USD) and 2.5 billion TL in 2003 (1.8 billion USD), and THY remained profitable despite the global economic crisis. THY has recently received several industry awards and, as a Star Alliance member, the company has acquired a market share of 8.7% for the number of passengers in Europe. THY has also sought to contribute to the Turkish economy in other ways such as by helping to "nation-brand" Turkey and to improve the country's image.

Source: Undersecretariat of Turkish Treasury (2013), Turkish Airlines Case Study.

As highlighted by this example, the listing of state-owned enterprises has brought significant improvements in their governance arrangements, including in their board practices and disclosure standards. In most

jurisdictions except the UAE where SOEs are exempt from the application of the domestic "comply or explain" corporate governance code, SOEs – even majority owned ones – are made subject to capital market regulations applicable to other listed companies. For example, the listing of Saudi Telecom in 2003, resulting in a 30% dilution in government ownership of the company, has introduced significant improvements in the governance arrangements of the company. Today, in accordance with the regulations of the Saudi Capital Markets Authority, one-third of the company board is composed of independent directors and compensation statistics for the board and management are published. In many ways, the company is seen as leading in terms of its governance practices in the local market.

Examples of listing of other companies such as DP World demonstrate similar benefits. The company's governance arrangements evolved gradually since its establishment in 1992 as a fully state-owned company, with the issuance of sukuk on NASDAQ Dubai in 2011 and its 2012 listing on the London Stock Exchange where a 20% stake in the company was sold to international investors. In compliance with the prevailing regime in London, DP World has a board composed of half independent directors and the company has adopted a number of leading governance practices in terms of addressing related party transactions (DP is a part of a group) and dealing with price-sensitive information.

Although these examples demonstrate the benefits of SOE listing to improving their governance arrangements, the listing of minority stakes in SOEs might risk creating an unstable structure, especially in instances where governments have social objectives. In such circumstances, trade sales may be a more stable structure but would not provide similar improvements in accountability and disclosure as IPOs. From this perspective, debt listings may be an intermediary solution that increases the quality of disclosure to the public, without introducing significant tensions in the shareholder base. Indeed, in recent years, debt issues by SOEs in the region have by far outpaced equity issues.

SOEs and irregular practices

Risks of corruption in SOEs

A criticism often levied against SOEs in the region, and indeed in other jurisdictions, is that they act as a conduit of corrupt practices. This is a serious allegation especially considering that SOEs can be considered as an extension of the public sector. Bribing a public official is in most jurisdictions penalised more harshly than commercial corruption. Moreover, corruption within these companies may imply a lack of adequate oversight or possibly misconduct within the public sector at large. For instance, fraud within Tunisian SOEs

perpetrated during the Ben Ali regime was indicative of the malfeasance within the executive branch of the government. Box 4.7 provides further details of instances of the corruption in the Tunisian SOE sector, uncovered in the aftermath of the regime change by the Tunisian Anti-corruption Commission.

Box 4.7. **Irregular practices in Tunisian SOEs**

The Tunisian Anti-Corruption Commission (La Commission Nationale d'Investigation sur la Corruption et la Malversation) was created the day after the Tunisian revolution. In January 2011, the president of the Commission was nominated and he selected other members of the Commission to investigate various charges of corruption and malfeasance. After having seized the archives of the former president of the Republic, the Commission immediately started investigations in 500 cases (out of 11 000 complaints received by the organisation). Of these, 400 cases were passed to the courts by end of 2011 for further investigation and prosecution.

The 2011 report of The Commission summarises its investigations, which have touched upon in a number of important respects on the operation and governance of state-owned enterprises under the previous regime. Notably, the Commission has shed light on a number of cases where serious abuses of procurement regulations, sale of government land and privatisation of SOEs benefitted members of the Ben Ali family or his partners. The Commission highlighted a number of factors that have led to the abuses by the executive, notably lack of controls and concentration of powers in the executive branch.

The character of cases highlighted by the Commission included declassification of public property to private and its attribution to members associated with the "ruling regime", the attribution of concessions and public procurement to parties that did not meet the selection criteria, the privatisation of SOEs to parties which did not submit best bids, as well as the issuance of licenses on highly lucrative activities (such as imports of automobiles) to individuals associated with the former regime.

For instance, in one of the cases uncovered by the Commission, the national company for distribution of petroleum launched a public procurement offer for the realisation of works and the purchase of equipment to store liquid carburant in the industrial zone Gabès. In this case, the procurement resulted in four bids by national and foreign competitors, some of which were within the budget of 65 million Tunisian dinars allocated to this project. One of the advisors to the President intervened in this case, forcing the company to select one particular bidder, which was not the lowest and the most attractive one.

Box 4.7. **Irregular practices in Tunisian SOEs** *(cont.)*

In another case, Tunisie Télécom was found to have accorded a number of large advertising contracts to a private company for a total amount of 48 million Tunisian dinars, without following either the public procurement procedures or the internal approval processes. The board never approved the contracts and the contracts were drafted in such a way as to absolve the advertising agency of any penalties that would normally be included in similar contracts (i.e. penalties for delays, etc.). The fees charged by the said advertising agency were excessive and the advances paid to the company were contradictory to Tunisian legislation. This case was also forwarded to the public prosecutor.

In yet another case, the privatisation of Ennakl, launched in 2004, was conducted to profit members of the Ben Ali Family. In this case, the offer to sell the company was limited to Tunisian companies only. The company was evaluated by an accounting expert, resulting in a low valuation that was later discovered not to truly reflect the prospects of the firm. The company was purchased below its market value by Princess Holding, a company controlled by the ex-president's family.

In addition, Ennakl did not pay dividends, amounting to 10 million Tunisian dinars to its shareholders (prior to the change of ownership). Following the transfer of ownership, the quotas of importation of automobiles increased almost four-fold, significantly improving the profitability of the company. 40% of the company's capital was sold through an IPO in 2009, for 53 million Tunisian of dinars, whereas the company was purchased by Princess Holding 3 years earlier for 22 million dinars. In all of these cases, and many others mentioned in the report, the Commission forwarded the files for prosecution to the relevant authorities. Further investigations are currently ongoing. New anti corruption legislation was adopted in 2011, following the proposal by the Anti-corruption Commission.

Source: Tunisian Anti-Corruption Commission (2012), Investigative Report on Corruption and Malfeasance, available in French and Arabic.

The cost of the mistrust in the public sector that can be created through corrupt hiring, procurement or sales practices adopted by SOEs can be significant and can have a wide-ranging impact on the quality of services provided by SOEs and the financial demands that these companies make on the public purse. While corruption in listed companies is dangerous in the sense that it can reduce shareholder wealth and undermine the trust of investors in public markets, corruption in state-owned companies can potentially affect a wider range of stakeholders, including employees, customers, suppliers and of course the state as the owner of SOEs.

Entities exercising ownership rights in SOEs (whether SWFs or Ministries), as well as the state audit bodies, the private sector and, finally, employees and consumers of SOEs' services have much at stake in ensuring that they are not seen as corrupt, if only to preserve the image of the state as credible and transparent. In the case of large and strategic SOEs, notably in the hydrocarbons sector, corruption or the perception thereof can have a wide-ranging systemic impact on the national economy, as is illustrated with the case of Algeria's Sonatrach in Box 4.8.

Box 4.8. **Bribery allegations around Algeria's Sonatrach**

In 2010, the head of Sonatrach, three of its vice presidents and the energy minister were all dismissed in the wake of a corruption investigation run by a powerful intelligence agency. While there might have been misdemeanour, many observers perceived the investigation as part of a political conflict within the Algerian political elite; many of the dismissed technocrats were reported to be close associates of the president.

In February 2013, a former Sonatrach Vice President published a letter in which he accused the leader of the intelligence service of harbouring a political agenda and requested that he investigate new bribery scandals involving Sonatrach and Italian and Canadian companies that have recently come to light due to lawsuits in courts outside Algeria.

In January 2013, Italian prosecutors announced an investigation into Italy's NOC Eni and its subsidiary Saipem for allegedly paying 197 million euros in bribes to secure an 11 billion euro contract with Sonatrach. The former vice president estimated that the country was losing between 3 billion and 6 billion USD annually to corruption just in the oil sector. His letter, as well as the bribery allegations, were widely discussed in the Algerian media.

Independent of the actual extent of bribery and of who exactly might be involved in it, it is clear that Sonatrach's image has been damaged and that the company enjoys limited political autonomy and operates under multiple political principals, which arguably undermines its operational efficiency.

Academic observers have described a rivalry between lower-level technocrats in Sonatrach and political elites that goes back for decades, as well as a well-organized union that has historically acted as a veto player on reforms. Although employment with Sonatrach is prestigious, it appears to lack managerial autonomy. The company's travails have probably contributed to Algeria's recent loss of market share in the global oil and gas markets. Sonatrach cannot be cited as an example of the more efficient NOCs in the MENA region.

Source: Schemm, P. (2013), "Algerians outraged over latest corruption accusations against state oil and gas behemoth", Fox News via Associated Press, 3 March.

A number of factors, including the lack of a centralised state ownership or oversight function, the loose accountability arrangements referred to in the first section of this report, as well as the lack of standardisation in hiring and procurement practices, raise the risk of corruption in SOEs. While listed companies in the region are overseen by securities authorities and to some extent by stock exchanges, the same is not true of state-owned companies, unless they have listed debt or equity. Instead, SOEs are typically overseen by state audit bodies, sectoral regulators and line ministries which exercise ownership stakes in them, but given the limited reporting they provide, the challenge of detecting corrupt practices may be potentially greater.

The nature of corrupt behaviours in SOEs is perhaps slightly different than in private firms. However, the range of governance mechanisms to fight corruption in state-owned companies is similar to those in private companies. Internal and external audit, rigorous board appointment and evaluation procedures, disclosure to the owners are all tools that improve the quality of governance arrangements in SOEs and at the same time minimise the risk of corruption. The nuances of how these procedures are implemented in SOEs merits further attention. For instance, in SOEs the lack of rigorous board nomination procedures can result in appointment of high-level public officials on SOE boards, which may find themselves hostage to political motives contradictory to the best interest of the company.

Considering that unlisted SOEs provide less reporting to the public and sometimes to their owners, these types of activities, and even outright embezzlement of funds, may go unnoticed more easily than in private companies where key shareholders are vigilant of the bottom line. As a result, particular attention is warranted to reduce the risk of corruption in SOEs and to optimise their performance more generally, including through steps such as setting specific performance targets for individual companies, streamlining board nomination procedures and ensuring that board appointments are reviewed by a central entity, introducing internal audit expertise and ensuring regular reporting to their owners and bodies which could potentially hold them accountable such as the parliament.

There is a growing recognition of the need to improve the general transparency and disclosure of unlisted SOEs and indeed the public sector at large, but concrete measures to improve the quality of disclosure by SOEs have been limited. The listing of debt of a number of large Gulf-based companies such as Emirates is anticipated to further improve the disclosure of SOEs (especially considering that the UAE intends to bring its debt prospectus rules in line with the European Prospectus Directive). For unlisted SOEs, gaps in disclosure and lack of independent audit, implies that very little is known about the incidence of corruption beyond anecdotal evidence.

Interest in anti-corruption growing

At the same time, the interest in the propriety of SOEs has grown in recent years as part of the general debate on public transparency encouraged by the events of the Arab Spring. For instance, as a result of these calls for greater public transparency and accountability, there is a growing focus on how MENA countries are ranked by Transparency International's annual rankings. These rankings highlight a significant variance in the positioning of MENA countries: Qatar and the UAE are ranked in a respectable 27th position (out of 174 counties ranked), while difficulties in containing corruption are visible in Egypt (118th place), Lebanon (128th), Syria (144th), Yemen (156th) and Iraq (169th).

Although the role of SOEs in this somewhat mixed picture is not known, it is potentially substantial, and there is a growing interest in the region as to how good corporate governance in SOEs could help them become not only more transparent and accountable but also "cleaner". This challenge is now being addressed by state audit bodies (SAIs) and national anti-corruption commissions. While state audit bodies in most countries (except Morocco and Oman) only a few years ago had no particular mandate or powers to oversee the efficiency and integrity of SOEs, this is starting to change. As a general rule, state audit bodies in the region now have the right to review companies where the state has at least a 25% stake. For these companies, SAIs are increasingly empowered to conduct operation audits and pre-audits, in addition to more conventional audits of the use of state funds and compliance with the relevant laws and regulations (e.g. Oman and Kuwait).

Table 4.2 provides an overview of powers of SAIs and anti-corruption entities in overseeing the dealings of SOEs.[17] The audit performed by SAIs is complementary to the external audit imposed on some but not large SOEs in the region. While SAIs typically have formal mandates to oversee SOEs and request information from management of these companies, the role of anti-corruption commissions is more limited in this regard. Some organisations such as the Lebanese Transparency Association (a chapter of the global TI), have been recently working on improving corporate governance practices with a view to limiting corruption and improving the efficiency and transparency of SOEs. However, most anti-corruption entities in the region are not given any formal mandate to work on issues related to transparency and accountability of SOEs, though discussions with these bodies indicate their interest to work on this subject.

An interesting trend is that some SAIs now also review the corporate governance practices of SOEs. In Morocco, for example, the State Auditor (Cour des Comptes) makes observations on any problems it sees with regard to the frequency of board meetings, the profile of board members and the quality of

Table 4.2. **Institutional oversight of SOEs in the MENA region**

	State Audit Institution	Anti-corruption commission/entity[1]
Algeria	Court of Accounts	Central Office Dealing With Corruption
Bahrain	National Audit Court	N/A
Egypt	Central Auditing Organisation	Transparency and Integrity Committee
Iraq	Board of Supreme Audit	Anti-corruption Commission
Jordan	Audit Bureau	Anti-Corruption Commission
Saudi Arabia	General Auditing Bureau	National Anti-Corruption Commission
Kuwait	State Audit Bureau	Authority for Integrity
Lebanon	Audit Court	Lebanese Transparency Association
Libya	Audit Court	N/A
Morocco	Court of Auditors	Central Authority for the Prevention of Corruption
Oman	State Audit and Administrative Institution	N/A
Qatar	State Audit Bureau	Administrative Control and Transparency Authority
Syria	Central Organisation of Financial Control	N/A
Tunisia	Court of Accounts	Anti-Corruption Commission
United Arab Emirates	State Audit Institutions (at the emirate level)	N/A
Yemen	Central Organisation for Control and Auditing	Supreme National Authority for Combating Corruption

1. The column referring to anti-corruption commissions in the region includes some government established and supported organisations and those which are civil society based.

Source: Moritz Schmoll.

disclosure provided. The Moroccan SAI is planning to issue a special report on SOEs in 2013.[18] In the Gulf, where state audit bodies were historically not mandated to review SOE performance (except Oman and Kuwait), they are also becoming more empowered to look into internal processes and procedures in SOEs. The case study of the Abu Dhabi Accountability Authority in Box 4.9 highlights the progress made by this entity in ensuring the propriety of domestic SOEs.[19]

Other SAIs in the region have been able to initiate and succeed in actions against fraudulent or improper practices in key SOEs. In Iraq, three managers of state-owned banks were arrested in 2010 following an investigation by the Anti-Corruption Commission that revealed that 360 million USD were missing from the Rafidain bank and the Agricultural Bank (Kami, 2010). SAIs in other countries may also be taking a stance against corruption in SOEs, but considering the limited reporting they provide to the public, the extent of this is currently unknown.

Public reporting of SAIs' activities is improving, although there is still a certain reluctance to publicise negative findings or prosecutions against SOEs or their agents for fear of backlash in public opinion. In particular, there is a concern that any information published by SAIs on remuneration of management or board members may be taken out of context in the public debate, despite the fact that by international standards they can be quite low.

Box 4.9. **Oversight of SOEs by Abu Dhabi Accountability Authority**

The Abu Dhabi Accountability Authority (ADAA) was established in December 2008, replacing the Audit Authority, with a similar mandate as other SAIs in the region. The Authority's main objectives are to ensure that public entities' resources are managed, collected and expended efficiently, effectively and economically; to ensure the accuracy of the financial reports and compliance of the public entities with the relevant laws, rules and regulations and governance guidelines; and to promote accountability and transparency principles at the public entities.

The scope of ADAA's work includes government departments, local authorities, institutions, companies and projects in which the government's share is not less than 50% and also the subsidiaries of these institutions, companies and projects. It therefore has the right to audit the 21 key local SOEs and their subsidiaries, estimated at 160 companies. In addition to the audit of companies' financial statements, the ADAA may provide recommendations to entities under its purview and conduct investigations into complaints referred to it, based on a set of criteria such as materiality, complexity of operations, performance challenges, and any concerns raised by stakeholders.

As can be witnessed from its 2012 annual report, ADAA has developed its competencies quite rapidly. Today, the entity has the capacity to conduct a variety of reviews, including service and outputs reviews, capital project reviews, procurement reviews, internal audit assessments and fraud risk reviews. ADAA can provide advice to entities it oversees upon an official request from the latter and with the approval of its chairman. As a result of its audits, ADAA has issued close to 700 comments, about 200 of which were considered requiring immediate attention of management.

ADAA was recently involved in investigating high-profile corruption cases, including a instance of embezzlement of nearly Dh 300 million (81 million USD) from the Abu Dhabi Water and Electricity Authority, which were given as bribes by companies in exchange for contracts. In another case, an SOE director was found to have awarded a tender worth Dh 900 000 (243 million USD) to a company owned by a close family member. In these cases, ADAA has taken active action as a plaintiff and has notified the Public Prosecutor to take further legal action.

Source: Abu Dhabi Accountability Authority Annual Report 2012; the National.

However, lack of disclosure of investigations by SAIs is not necessarily indicative of their weakness: some of them (e.g. Kuwaiti and Omani SAIs) have wide powers although they do not provide much public reporting. In Kuwait in particular, the State Audit Body can appoint its representative to supervise

company operations on site as long as government ownership exceeds a quarter of the capital (OECD, 2012a).

Although clear progress can be seen in the development of SAIs as "guardians" of state assets, one potential issue in the operation of SAIs in the region is that not all SOEs fall under their scope. In Egypt for instance, the Administrative Monitoring Authority, established to combat corruption in the country, can investigate any entity in the government, including state-owned enterprises, except for those controlled by the military (Sayigh, 2012). This is despite existing legislation that considers any improper dealings in SOEs "theft of public assets", which carries heavy criminal sanctions. In other countries such as Lebanon, even though the SAI theoretically can investigate SOEs, in practice it does not do so due to a lack of political support. The efficacy of SAIs, including vis-a-vis SOEs, lies in their reporting relationship with the executive, their political backing and the scope of their mandate.

The mandate of anti-corruption commissions in the region also enables them to play a role in monitoring and reporting any incidence of impropriety in local SOEs. This is so especially since anti-corruption commissions or bodies are becoming more widespread in the region, including the recently established Saudi National Anti-Corruption Commission, Kuwait's Authority for Integrity, and the Moroccan Anti-Corruption Commission. In Saudi Arabia for example, legislation defining the structure of the new Commission was adopted in 2011, enabling it to oversee all state-owned companies in which the state has a stake exceeding 25%. The commission was given the status of an independent legal entity, and its chairman given the status of minister reporting directly to the King.

Corruption in procurement

It is crucial that SAIs and anti-corruption commissions have the mandate and the resources to examine various sources of nepotism, corruption and theft that may occur in public enterprises and to forward such cases to the public prosecutor. Apart from a higher incidence of nepotism, global experience highlights that SOEs are particularly prone to financial risks arising from inefficient or insufficiently transparent and structured procurement procedures. Considering that large SOEs are active as contractors for a variety of goods and services, any inefficiency or improper selection of bidders can have a serious impact on the public purse. Box 4.10 provides further information on OECD instruments that can provide assistance to governments looking to structure their procurement process with a view to improve its transparency and efficiency.

A number of MENA countries have reviewed their procurement procedures, inter alia, to ensure that SOEs are subject to the same standards

Box 4.10. **OECD instruments promoting integrity in public procurement**

Public procurement is estimated at 10-15% of global GDP and bribery is estimated to add 10-20% to total contract costs. The OECD Principles on Public Procurement were developed in 2009 to provide policy guidance to governments on measures that can help them prevent waste, fraud and corruption in public procurement. This document consists of ten key principles to help eliminate corrupt practices of all forms – nepotism, clientelism, kickbacks, theft of resources, collusion, abuse and manipulation of information, discriminatory treatment, waste of organisational resources and also conflicts of interest in public service and in post-public employment.

The Principles are based on four key pillars, including transparency in the procurement process, professional management of the process, prevention of misconduct, and ensuring accountability and control. The Checklist for Enhancing Integrity in Public Procurement provides a practical tool for detecting corruption at all stages of the procurement cycle, including pre-tendering, tendering, post-tendering.

In addition, the OECD Guidelines for Fighting Bid Rigging in Public Procurement address specifically the risks of bid rigging (or collusive tendering) whereby competitors in a particular tender offer would collude in order to illegitimately maximize profits. Bid rigging can take a number of forms (i.e. cover bidding, bid suppression, bid rotation, market allocation), but ultimately it impedes the efforts of public organisations to obtain goods and services at the lowest price.

The Guidelines provide advice on measures that can be adopted in order to reduce the risk of big rigging in public (but also private) procurement. For instance, the Guidelines recommend that the procuring entity coordinate with other public sector clients who have recently purchased similar products or services in order to improve market understanding. The Guidelines also recommend avoiding unnecessary restrictions that might reduce the number of qualified bidders and streamlining the tendering process.

Indeed, this latter recommendation is important in the region since such restrictions have in the past been utilised in order to skew results of procurement processes. In Tunisia, it is reported that under the previous regime, the executive commonly interfered directly in the public procurement process, including by SOEs, in order to ensure that selected elites win large public tenders. At times, companies participating in public tenders were "asked" to withdraw their offer in order to allow a less attractive bid to win the tender; in other instances, the Director Generals of Ministries or executives in companies were "asked" to select a given bid due to undisclosed strategic considerations.

Source: OECD Principles for Integrity in Public Procurement, 2009; *OECD Guidelines for Fighting Bid Rigging in Public Procurement*, 2012; The Checklist for Enhancing Integrity in Public Procurement, 2008; Tunisian Anti-Corruption Commission (2012), *Investigative Report on Corruption and Malfeasance*, available in French and Arabic.

that apply to the public sector more generally. For example, in Oman all fully state-owned enterprises (but not those with mixed ownership) are required to issue tenders and government procurement is supervised by a high-level Tender Board, which is an independent entity not attached to any other government entity (World Trade Organisation, 2008). In other countries of the region however, the SOE sector generally or some SOEs specifically, are exempt from procurement rules that apply to the public sector at large.

In Kuwait for instance, procurement by SOEs is not subject to the regulations applying to general government procurement and is thus not supervised by the Central Tenders Committee (World Trade Organisation, 2012).[20] In Morocco, procurement by SOEs, as by other public entities, is decentralised and subject to ministerial approval.[21] The new procurement decree adopted in 2007 only applies to one category of SOEs – public establishments (établissements publiques) – and recent WTO reviews demonstrate that they do not always apply it. In other countries of the region such as Libya and Lebanon, procurement regulations are loose and therefore arrangements whereby SOEs procure services from companies owned by Ministers or other high level officials can be found.[22] Box 4.11 demonstrates that even in an environment where legislation may allow a diversity of approaches, some companies take a leading role in addressing the risk of corruption, including in procurement.

Box 4.11. **Anti-corruption drive at the Moroccan National Electricity Company**

The Moroccan National Electricity Company (Office National de l'Électricité) is one of the largest SOEs in the country, with almost 4.5 million customers. It is a public establishment focused on the production, transportation and distribution of electricity. After the government itself, it is the largest investor in the country and hence its procurement activities are supervised by the Court of Accounts, the Directorate of State-Owned Enterprises and Public Establishments and the Parliament (through specific parliamentary committees). In order to minimise the risk of corruption, the National Electricity Board has taken a proactive stance to strengthen the integrity of its procedures.

It has established an Ethics Committee in 2007 that includes the main private sector body (i.e. CGEM) and staff representatives. The remit of this Committee is to propose binding ethical rules and procedures for both staff and other stakeholders, including suppliers. Its first task was to develop a code of ethics. In the consultation process for preparing the code, a representative sample that included not only managers but also operational staff were involved. Adherence to the code has been made voluntary, as a means of encouraging all staff to sign on willingly. The next task will be to evaluate conflict of interest risks within the firm.

Box 4.11. **Anti-corruption drive at the Moroccan National Electricity Company** *(cont.)*

The company is also using new technologies to strengthen transparency and accountability in procurement. It published invitations to tender on its website even before the 2007 decree made this mandatory. It also maintains a database not only for storing information on calls for tender but, more generally, to keep records of decisions taken in the procurement process. Information on suppliers is centralised and classified to facilitate evaluations on the basis of objective parameters such as price and timeliness of delivery.

The practices adopted by the Electricity Company are considered in line with the regulations introduced in Morocco in 2007 that established a comprehensive framework for public procurement. However, the 2007 decree applies only to the central government and local authorities, whereby public enterprises can adopt their own regulations provided that they comply with the general regulations on competition and transparency. The need to harmonise the existing regulations for all public enterprises with the provisions of the 2007 decree was noted by the OECD review of the public procurement framework of Morocco.

Source: Office National de L'Électricité, 2012; *OECD Principles for Public Procurement*, 2012, interview, Kamal Daoudi, State Audit of Morocco; OECD (2009), *Enhancing Integrity in Public Procurement: A Joint Learning Study on Morocco*, Paris, France.

The lack of streamlined procedures for public procurement in some MENA countries has led to allegations of impropriety which – even if proven to be unfounded – can stain the reputation of SOEs and governments as their owners. Considering suspicious incidents are not always investigated and the findings of investigations are usually rendered public, the perception that dealings by SOEs' are often corrupt is no uncommon in the region. Box 4.12 explores some of the allegations made against the state-owned Casino du Liban, one of the largest government-owned companies in Lebanon. This case study highlights that good governance at the level of the management and the board is directly related the transparency of procurement procedures. It also demonstrates that in SOEs, much as in listed companies, good governance is also about setting the tone at the top.

Box 4.12. **Corruption allegations at Casino du Liban**

Casino Liban is one of the largest state-owned enterprises in Lebanon and is one of the key tourist attractions in Lebanon. Over half of its outstanding shares, which but trade over the counter on the Beirut Stock Exchange, are held by Intra Investment Company, the government-controlled investment firm. The remaining capital is held by Abela Group (17%), Bank Audi (7%), and by individual investors. The Intra Investment Company fell under the ownership of the Lebanese government in 1966.

Box 4.12. **Corruption allegations at Casino du Liban** *(cont.)*

About half of the capital of Intra Investment Company is owned by the Central Bank and the Ministry of Finance, and although plans to sell the stake were discussed in 2006, the sale did not materialise. Today, the ownership of the company remains unchanged and therefore, it remains majority owned by the Lebanese state.

Under a 30-year contract between the government and the Casino entered into in 1995, 30% of its gross revenues are to be transferred to the Ministry of Finance in the first ten years, increasing to 40% and eventually to 50% subsequent years. The management of the Casino claims that it transferred the required sums, in addition to 141 million USD in 2010-11 in taxes paid to the Treasury.

In November 2009, the general assembly of the company elected a new board of directors for a three-year term. Since then, the over-the-counter value of the shares of the company has increased significantly, from approximately 360 USD per share to 580 USD per share today. Unlike other Lebanese SOEs mentioned in this report, the company has remained profitable (its 2012 profits are projected to reach over 30 million USD).

Nonetheless, its governance arrangements continue to raise public concerns on several fronts. In November 2012, allegations of corruption, political favouritism and embezzlement at Casino Liban were made in the local press. Among the claims made against company management is that it tends to provide full time employment only to those who are affiliated with the administration. The company is estimated to employ 260 contract workers, who much like contract workers at other state-owned enterprises in Lebanon, have protested against their employment status, which they believe to be unjust.

The Casino has a contract with Abela, which also owns a significant stake in the company, to operate gambling machines and this represents a conflict of interest in procurement procedures. No public tender for this service was issued. The part time workers of the Casino argue that the company could save up to 4 million USD annually if they were offered full time jobs and if the contract with Abela was revoked. The Casino has not undertaken a cost-benefit study of this option.

In addition, reports in the media have surfaced earlier in 2012 alleging that the management of the company has purchased 10 million USD in slot machines, while similar machines were stored in the company depot (unauthorised by the Ministry of Finance because they targeted low to middle income earners). Local press reported that two board members of the company travelled to Monaco to arrange for the purchase of the machines through an intermediary, and not directly from the manufacturers as was commonly done before.

Box 4.12. **Corruption allegations at Casino du Liban** *(cont.)*

No tender offer was issued and no bids were considered for this purchase, which raised suspicions that company insiders might have received kickbacks in this sale. Moreover, the board has allegedly not asked the approval of the Ministry of Finance, which is a major shareholder. The company has not held any general assembly meetings in five years, and a result, shareholders have not had a discussion about the allegations of unjust hiring and procurement practices which, if proven, could have had a negative impact on its performance.

Source: LBC; The Daily Star, Banque Libano-Francaise; Alakhbar English; Byblos Bank.

Ownership arrangements and anti-corruption

In addition to ownership and disclosure frameworks that might make SOEs especially prone to corruption, the process of privatisation can also be tainted by corruption. The Arab Spring has highlighted that the process of transfer of ownership from state to private hands is fraught with risks of corruption. In Egypt in particular, allegations were made that state-owned assets were often transferred at a fraction of their market value to parties affiliated with the government. Likewise, in Tunisia, evidence has emerged that some companies were privatised in ways that encouraged the emergence of crony capitalism. Even some of the largest privatisation transactions, such as the sale of a 35% stake in Tunisie Télécom, were subject to serious violations in the candidate selection procedures and a number of smaller SOEs were sold to companies owned by members of the Ben Ali family (Tunisian Anti-Corruption Commission, 2011). Although some of these sales were conducted through direct negotiation with a strategic buyer, in some cases open tender processes were manipulated to result in an outcome desired by the regime.

These allegations highlight the need for the privatisation process to be handled by a high level governmental entity with utmost public integrity. The establishment of entities explicitly charged with privatising SOEs such as the executive privatisation councils in Jordan, Oman and Kuwait may be effective not only in centralising privatisation expertise within the public administration, but also may help to improve the integrity of the privatisation process itself, assuming such entities enjoy the necessary operational independence. A number of privatisation entities in the region already appear to enjoy such autonomy. In Jordan, the Executive Privatisation Commission is financially and administratively independent and the decision to hire or dispose of its Chairman is made by the Prime Minister subject to approval by the Cabinet of Ministers. The new Privatisation Council established in Kuwait in 2012 operates with an independent budget, though most of its members are ministers.

Centralisation or at least co-ordination of procedures regarding privatisation and more generally operation of SOEs appears to have had a positive impact on the transparency and integrity of SOEs. Hiring policies are one area where progress remains to be made: so far, no MENA country has introduced requirements for the selection of management and board candidates, instead leaving it up to the individual ownership entities and even companies to decide on appropriate policies. While this “laissez-faire” approach may be beneficial considering the variety of sectors where SOEs operate, the risk of nepotism is amplified in this context.

Some countries such as Egypt have codified the nomination procedures for boards of SOEs (through the Business Public Law), but generally, board nomination procedures and selection for managerial posts in the region remains relatively ad-hoc. One of the reasons for this is that the flexibility in hiring practices allows for key posts to be held by political nominees. In addition to line ministries which may have an interest to promote political appointees in certain posts, other entities may wish to influence this process. For instance, in Egypt, it is reported that the Supreme Council of Armed Forces (SCAF) continues to appoint retired generals and other high ranking officials on boards of SOEs, including companies outside of the military establishment (Abul-Magd, 2012).[23]

One Lebanese ex-minister admitted that his total remuneration was lower compare with some of his senior staff due to the fact that they cumulated posts as board members in SOEs in which his ministry exercised ownership rights. These individuals were not necessarily appointed by the state in order to maximise the effectiveness of its representation on the board, but to provide them with a means to supplement their public sector salary. A similar situation also prevails in other MENA countries where civil servants seek to complement their civil service salaries with board fees, a practice which is almost certain to create conflicts of interest.[24] Accumulation of board positions is particularly prevalent in smaller GCC countries where technocratic elites are small and the appointment of independent directors with specialised expertise is still rare.

Anti-corruption and corporate governance

Increasingly, anti-corruption and good corporate governance in the region are seen as two sides of the same coin. The need to render SOEs more transparent and accountable, while at the same ensuring that they operate in a context of robust regulatory framework designed to ensure their efficiency and profitability, has resulted in a growing interest of policy makers in good governance of SOEs. Realising that governance failures such as inadequate risk management procedures or ineffective boards have real and significant

repercussions, policy makers in the region are now looking at solutions to make companies under their ownership more accountable and competitive.

A first clear sign of a political will to bring state-owned companies to a higher standard of governance emanated from Egypt, which introduced a code of corporate governance for SOEs already in 2006. This initiative was followed by similar initiatives in Morocco in 2008 and other MENA countries since (see Table 4.3). In addition, listed SOEs are subject to corporate governance requirements imposed by the securities law and regulations (with the exception of the UAE).

Table 4.3. **Corporate governance guidelines for SOEs in the MENA region**

	General corporate governance code			Guidelines on corporate governance of SOEs		
	Date of issue	Issuing organisation	Status	Date of issue	Issuing organisation	Status
Egypt	2005	Egyptian Institute of Directors	Voluntary	2006[1]	Egyptian Institute of Directors	Voluntary but application encouraged by the Ministry of Investment
Morocco	2008	Moroccan Corporate Governance Commission	Voluntary although companies encouraged to comply-or-explain	2011	Moroccan Corporate Governance Commission	Voluntary although companies encouraged to comply-or-explain
Lebanon	2006	Lebanese Transparency Association	Voluntary	2012 (issued as draft)	Lebanese Transparency Association	Voluntary
Bahrain	2010	National Corporate Governance Committee	Voluntary	2012	Mumtalakat	Voluntary[2]
Dubai	2007	Emirates Securities and Commodities Authority	Comply-or- explain	Under preparation[3]	Executive Council	–
Abu Dhabi		Emirates Securities and Commodities Authority	Comply-or- explain	Under preparation	Executive Council	–

1. Complemented by the Public Companies Law outlining the governance requirements for the sectoral holding companies and the individual SOEs.
2. The scope addresses only the governance of enterprises where Bahrain's SWF Mumtalakat has ownership.
3. In addition, sectoral guidelines for real estate developers have been developed.

Source: OECD Secretariat research, based on review on national codes and discussions with MENA SOE Taskforce members.

In addition to these requirements, state-owned banks are often governed by the regulations issued by central banks. While in most cases pre-dating general corporate governance codes and guidelines, CB regulations are being

amended to take into consideration lessons learned from the financial crisis, and in the case of come countries, to address the gaps discovered after political transitions. For example, in the case of Tunisia, the Central Bank issued new regulations for banks (and indeed all credit establishments) following the revolution to address weaknesses in the corporate governance of these establishments, aiming to promote the role of the board and address related borrowing concerns.

In the UAE, the central bank in 2012 required local financial institutions to limit their exposure to the governments of the seven-member UAE federation and related entities to a maximum of 100% of their capital base, and exposure to individual public sector borrowers to 25%. This measure was adopted as a reaction to the Dubai crisis which saw defaults on loans by several large state-owned companies, which created significant liquidity issues in the local banking market. The fact that many UAE banks are themselves partially state-owned – sometimes through holding entities that are related to the SOEs they lend to – exacerbated the situation.

Sectoral regulations also in some cases address governance structures and practices of state-owned companies. For example, the Dubai Real Estate Regulatory Agency (RERA) has developed a code of corporate governance for real estate developers in 2011. In doing so, RERA has considered that the peculiarity of the real estate sector, which includes many actors such as developers and promoters, merits specific guidelines. Although these guidelines are not specifically targeted at state-owned companies, the fact that real estate development in Dubai is to an important extent controlled by SOEs such as Nakheel, Emaar and Dubai Properties (a subsidiary of Dubai Holding) implies that SOEs are also addressed by these recommendations.

Last but not least, some standards of governance are imposed by sovereign funds whose stake in companies in the region is reported to have grown significantly over the past 3 years. For example, the Bahraini sovereign wealth fund Mumtalakat, which owns stakes in a number of large SOEs such as Alba and Gulf Air, has issued a *Director's Handbook*. The objective of this *Handbook* is to educate directors that serve on boards of companies it owns of their responsibilities. It specifies that board members have a legal duty to act in the interest of the company and stipulates that while directors should also pay regard to the interests of other stakeholders, their primary concern should be with protecting the interests of shareholders and maximising long-term shareholder value.

All these developments clearly point to a heightened interest of policy makers to improve governance of SOEs. With the exception of a few countries, these initiatives generally reflect a careful and somewhat fragmented approach, indicating a reluctance to impose a new set of standards on highly

strategic companies. These initiatives are primarily aimed at improving transparency of SOEs vis-à-vis the decision-makers and their impact on increasing public accountability and transparency is so far unclear. What is certain, however, is that policy makers are now interested in ensuring that at the minimum, SOEs provide the necessary reporting to them both on their performance and their progress in reforming their governance arrangements.

Notes

1. For further information, please refer to the Public Authority for Civil Information: *www.paci.gov.kw/en/index.php/statistics/statistics-indicators*.
2. Author interviews with Syrian SOE managers, Damascus, summer 2009.
3. In Algeria e.g., the public sector represented 34% of total employment of 7.8 million in 2004, but paid 72% of the national wage bill.
4. Iraq appears to be an intermediate case with subsidies to SOEs amounting to between 1.5 and 4.2% of state spending in 2007-10 (Wing, 2013).
5. A breakdown of SOE and private lending was not available for later years.
6. Direct loans to the Jordanian government are more substantial, but are less than half the size of private sector loans. Some of the private sector loans probably include companies in which the state holds minority shares, but this is unlikely to change the picture substantially.
7. The GCC Secretariat is understood to be preparing a competition law although it is unclear whether it will apply to SOEs as well as private companies.
8. The exemption must be shown to be in the public interest or offer benefits to the consumers that exceed the effects of restricting freedom of competition.
9. Technically, the ECA can start an investigation on its own initiative or as a result of a complaint, but in practice most of the market studies that it has worked on so far were the result of a ministerial request.
10. For example, in Lebanon, a competition law was adopted but no entity to oversee its implementation was created.
11. The Ministry of General Affairs and Governance is in the process of putting together processes allowing better coordination between the Competition Council and other sectoral regulators.
12. Egypt remains somewhat of an outlier in this regard in the sense that all drinking water and sanitation entities are regrouped under a single holding company and the regulatory framework in place with regard to cost recovery and tariffs has so far not been able to attract external financial investment or direct participation.
13. A peculiarity in the Gulf is that in a number of markets, local state-owned operators compete with foreign state-owned operators (e.g. STC and Qtel in Kuwait, Etisalat in Saudi Arabia).
14. This is especially important given that the penetration of mobile telephony in particular enables the poor in rural areas to conduct business remotely thus reducing poverty levels.

15. In Jordan, this is to some extent alleviated by the fact that the competition authority is chaired by the Minister of Industry and Trade, with other board members including officials from the Insurance Commission, the Telecommunications Regulatory Commission, the Public Transport Regulatory Commission, the Jordan Chamber of Commerce and Industry, the Jordan Consumer Protection Society and others.
16. In some cases such as the Saudi one, aggregate figures for subsidies are explicitly listed in national budgets, but the category excludes the most important in-kind subsidies such as the provision of cheap energy and fuels.
17. SOE operations are usually also overseen by the Ministry of Finance and/or the line ministry in charge of the relevant sector.
18. This would be a first effort by a SAI from the region to examine SOEs specifically.
19. These changes reinforce other legislative changes in the Emirate, notably the anticipated issuance of corporate governance guidelines for SOEs and the establishment of the UAE State Audit Court at the federal level.
20. In addition, Kuwaiti government agencies, including unincorporated SOEs, may seek exceptions from the Central Tenders Committee to conduct tenders outside the law; procurement by hydrocarbon companies is also excluded from the Public Tenders Law, although the individual companies have their own regulations.
21. Morocco is not the only country in the region with a decentralised approach to procurement. In the Emirates, procurement at the emirate level is not regulated by the Public Tenders Law, allowing individual government entities freedom to establish their own rules and procedures.
22. For instance, the General Electric Company of Libya hired companies under its control to perform services without conducting public tenders, resulting in a situation where it was at the same time the owner, the contractor and the consultant (Khan, 2012).
23. For instance, the head of strategic companies such as Suez Gas and Red Sea Ports are retired generals. Ex-generals are also on the boards of commercial SOEs organised under the Ministry of Investment (Abul-Magd, 2012).
24. On the other hand, some countries of the region such as Tunisia have low board fees which are same across SOEs, irrespective of their size and complexity. This practice does not encourage the attraction of talented individuals to serve on SOE boards, especially considering the high legal liability. This, in turn, poses problems for long term competitiveness of SOEs, especially in sectors such as banking where board members and executives in the private sector are remunerated in a competitive fashion.

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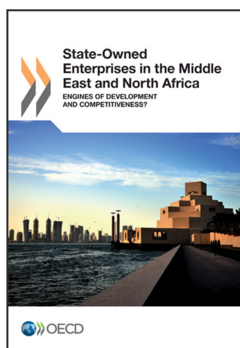

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