Development cooperation: state-owned enterprises, public services and economy of developing countries

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PURPOSE : to propose a more active role for the EC in the debate on State Owned Enterprises (SOEs) in Developing Countries. CONTENT : for some years there has been pressure on developing countries to reform SOEs. This pressure has been prompted by the heavy burden of SOE losses and economic inefficiency on macro-economic and fiscal balances and growth. Though the Commission has often linked its budget support programmes to adjustment conditionality of the Bretton Woods Institutions (BWIs), it has not always been explicit on the specifics of SOE reform included in adjustment programmes. The Commission argues that there are several compelling reasons for a more active involvement of the EC on the issue of SOE reform; - the impact of SOE reform on the economies of developing countries can affect the achievement of the Millennium Development Goals, to which the EU is firmly committed. This effect could be positive, through reduced fiscal deficits, increased economic growth, improved provision of essential services and building of management capacity, if reform is effective. It could be negative, through increased unemployment, reduced access to basic services, loss of managerial and administrative know-how and increased corruption if it is not successful; - Member States have broad expertise in SOE reform. The EU has unique experience of combining economic liberalisation with common "rules of the game", and an unequalled record of reconciling competitive markets with the provision of services of general interest; - the EC already supports many SOE reform programmes - whether privatisation or other forms of change - directly or, more often, indirectly within the framework of adjustment programmes led by the Bretton Woods Institutions (BWIs). The Communication goes on to review the reasons behind the build-up of a large public sector in developing countries. It notes the political nature of some of the key choices involved. It highlights the reasons for reforming SOEs, discusses the risks and benefits of different types of reform, and suggests lessons for best practice for both recipient governments and donors. Public utilities are something of a special case, and of growing importance in the debate. They are frequently characterised by natural monopolies, and each field has specific characteristics that make the debate complex. The importance of the regulatory framework is, however, particularly evident for all public utilities. In general, the key issues are about the access, affordability and quality of each service and quality and efficiency of management. The Commission's guidelines on SOE reform highlight the following: - governments need to define their objectives clearly, in ways that can be monitored transparently. They must decide what is the most important issue for their citizens: service quality or accessibility, fiscal gains or employment generation, taking account of benefits, costs, resources and alternative uses. Decisions like these are fundamentally political decisions and need to be made explicit and transparent if governments are to be held properly accountable; - before deciding on a formula for reform, governments need toexamine all the options, including restructuring within the public sector, PPP, privatisation, and mutualisation, analysing the impact they are likely to have on access, affordability, and quality of services and goods, on public finances and on the country's economy. This assessment should also take into account the employment and social consequences; - transparency in both design and implementation is critical to the outcome of reform. A lack of transparency implies higher risk of corruption and poor information during the process can undermine the confidence of public opinion and oblige the government to reverse the reform; - the design of the regulatory framework and monitoring of post-reform performance are key issues, which have an influence on all the impacts analysed so far. The benefits of a proper regulation and control range from direct reduction of poverty to consumer protection, from better quality of service to less corruption. The Commission advocates technical assistance as well as financial assistance; - SOE reform in developing countries requires a marked increase in the level of foreign direct investment flows. For this to happen governments must create a conducive climate based on peace, democracy and stability, a stable macroeconomic environment, a transparent and predictable fiscal

system, enforcement of the rule of law by an independent judiciary, and respect for human rights; - sequencing is crucial and an important sequencing issue is the inclusion of the financial sector reform, given the impact, which unreformed banking institutions, can have on the incentives confronting enterprises during the reform process; - any reform should include an appropriate social protection strategy; EC discussions with the developing countries concerned, and with the BWI, should take place prior to any SOE reform which directly or indirectly involves the EC. European Commission Delegations would need to play an active role in the discussions to be held at country level during PRSP processes or during BWI missions. They would concentrate on the objectives of reform, identification and assessment of reform options, including sequencing issues, the requirements of post-reform regulation and monitoring and the need to address employment and social implications in a consistent and integrated way. Member States should also be involved in these talks.