4. PRIVATIZATION ISSUES

This section addresses the issues, and the decisions which governments themselves must make prior to embarking upon a privatization process. They may vary from project to project. The initial groundwork and clarification of objectives recommended herein should enable governmental sponsors of ports privatization to chart their course with greater clarity. This in turn should lead to a smoother, faster internal process. It should also attract a greater number of interested, qualified and eligible investors/operators; thereby, providing government with the widest range of choice and the best opportunity of achieving objectives.

4.1 Reasons for privatization/commercialization

The desire to involve the private sector in the management and provision of port infrastructure and services is prompted by the recognition that government regulations and processes are not always conducive to efficient operations of commercial activities and by recognition of the private sector’s relative strength in this field. Also, in recognizing that investment sources outside government must be tapped in the provision of such infrastructure and services involvement of the private sector provides the opportunity to share risks and, in times of rapidly changing economic environment to respond quickly to market/demands and opportunities. The principal strengths of the private sector are:

a) A much stronger management capability due to its ability to recruit and compensate qualified managers and technicians;

b) Relative freedom to operate outside of political and bureaucratic constraints (e.g. in procurement and the working of overtime);

c) Better company specific labour management;

d) Potentially greater experience in developing facilities and providing services attuned to the competitive world of global trade; and

e) Access to non-traditional resources for investment in the infrastructure to serve trade which some individual governments may lack.

These attributes of the private sector enable it to respond rapidly to market changes through speedy decision making and investment.

Government policy to promote private sector involvement may, therefore, include the following long-term aims which can be achieved through partnership:
a) Improve efficiency and productivity of operations

One of the foremost if not the primary reason for involving the private sector in the operation and management of ports is to increase efficiency. It is generally considered that a profit oriented investor operating in a competitive environment will strive to minimise costs and improve services. These are necessary measures if the operator is to retain and expand the clientele whilst earning a satisfactory return on investment. With this in mind some governments have turned to the private sector to exploit the functioning of this market discipline in their ports.

The Government's objective is not to achieve profits for the private investor per se. Rather the goal is to improve efficiency and thereby reap the benefits of lower cost and improved services for importers and exporters. Enhanced transport performance also makes a nation more attractive for new investors that will be major consumers of transport services, for example, foreign and domestic industrialists.

b) Reduce the financial and administrative burden on the public sector

Public management of a port or a system of ports on a day-to-day basis generates a considerable demand on governmental resources in terms of time and personnel for what is largely a commercial enterprise. Whilst this resource demand falls most heavily on directly concerned ministries and agencies (e.g., Transport) it can be shown that it frequently spills over to those peripherally involved (e.g., Treasury) organization and even to the Cabinet itself.

In the process of re-engineering the functions they undertake some governments have adopted privatization, at least in part, for the ports sector. Whilst professionals in government will continue to be required to manage the residual responsibilities that the government chooses to retain, they will only be a fraction of those that were on the public roster when it played the combined roles of owner, manager, operator and regulator. The argument can be made in many countries, however, that there need not be an overall diminution of employment in the sector as increased efficiencies and enhanced performance can lead to greater competitiveness resulting in growing throughput and resultant demand for staff.

Transferring activities to the private sector puts them into the business realm where only those positions which are required to undertake the successful and profitable commercial mission of the port, are retained. Thus, not only will there be a substantial reduction in governmental personnel focussed on the port, but also a reduction in the total number of managers and labour involved per fixed amount of traffic handled.

c) Generate maximum revenue and reduce investment

A valid reason for the privatization of ports can be to generate increased revenue for the government. This can be achieved through improvements in efficiency and reductions in costs which can be translated into profit sharing possibilities. Importantly, government can also reduce its risk in terms of revenue expectation by divorcing lease payments from the amount of cargo throughput; however, this would be at the cost of forgoing increased income from expanded
traffic levels. If this is the principal objective it is important that it be acknowledged as its successful attainment will be determined by the approach adopted.

d) Social objective

A number of governments, including Malaysia, have adopted privatization in part as a tool of broader social policies aimed at redistributing wealth or moving marginal communities closer to the middle of the economic mainstream. The aims of such policies cannot be faulted, but where they are to be applied they should be clearly enunciated.

Privatization decisions based on social objectives will have direct implications as to the implementation approach ultimately adopted. As with all privatization objectives, such an approach should be devised not only with the social target in mind but should ensure that the preferred role of the port is also achieved.

e) Promote private sector involvement in the economy

Some Asian economies have been primarily driven for several decades by governmental spending. The Government's role has been pervasive resulting in a large bureaucracy. Even industrial activities, transport, distribution and retailing have been carried out, at least in part, by public sector enterprises, which has directly inhibited private sector investment and large segments of the private sector may have atrophied.

To redress this situation, one motive announced by some governments for privatization is to increase opportunities for private investors, either directly or through share purchases. The intent is to create enhanced entrepreneurial activity with anticipated multiplier effects throughout the economy.

f) Attract new or additional business and trade

On some occasions private project sponsors are solicited who are already involved in trade or transport services (e.g., shipping lines). The rationale is that if a port user such as a shipping line which controls a significant amount of cargo becomes an investor, it can be expected that much of the investor's traffic, which may be discretionary in its routing, will be funnelled through the port.

If this motivation applies to a particular privatization programme, care should be taken in the formulation of any pre-qualification of bidders and in actual contract negotiation. For example, some shipping lines have a separate stevedoring or terminal management subsidiaries so that arrangements with the port operating group will not necessarily ensure capture of the parent company's business. Obviously, actual investment by the group is more likely to generate a focus on a particular port than will a simple management contract.
g) Risk sharing

Within any approach to involving the private sector in the financing and operation of ports and related activities, an additional important element is the sharing of risk. Clearly it is important to define the objectives of the programme of commercialization/privatization as it will serve as a measure of risk. While this is dealt with in a later section related to the protection of the investor/operator, it can be an important reason for governments to consider involving the private sector as a means of reducing exposure to economic, technological and management risk.

The consequential objectives arising out of these long-term policy aims may include a number of the following:

a) Promoting private sector involvement in the development of port infrastructure or provision of services;

b) Reducing the need for government investments in the sector;

c) Upgrading the professional skills of port managers, staff and workers;

d) Creating competitiveness in the provision of port services and operations;

e) Reducing/eliminating surplus dock workers and restrictive labour practices;

f) Spreading the ownership of the ports (affirmative action); and

g) Attracting foreign investment and importing foreign expertise.

At the operational level, the policy aims may be translated into the following operational objectives which will require the formulation of a comprehensive port development strategy:

a) Establishing quantifiable operational targets (e.g. what level of efficiency and productivity of the port may reasonably be expected to achieve);

b) Determining the throughput capacities of the various elements of the port;

c) Identifying the facilities or services in which private sector participation is desirable or should be promoted;

d) Assessing the true operating costs of the port to provide a basis for the "privatization" exercise;

e) Identifying alternative funding sources, including whether foreign investment is necessary or desirable and the means through which such investment could be attracted to the port;

f) Identifying the areas where new technologies might be introduced; and
g) Formulating a strategy for rationalizing labour structure and practices.

It is important that there be a clear internal (and preferably external) understanding as to what specifically the government intends to accomplish via its commercialization and privatization programmes. The conclusions reached in the above considerations, when coupled with the factors addressed in the following section, provide the essential framework for devising the most effective project-specific approach to commercialization or private sector participation.

By comparison with the complex framework within which government operates, the private sector functions within a commercial environment which is relatively straightforward and easily defined. This in itself is one of the strengths of the private sector and given adequate freedom to operate, allows the private sector to focus its resources on specific criteria of success. Among the primary private sector objectives of joining public-private sector partnerships and which may be harnessed in achieving broader goals are:

a) Profit

An overriding aim of the private sector is to make an appropriate return on its investment. It is this consideration which is the driving force in a competitive environment, and which encourages attainment of the highest levels of efficiency. An objective of the private sector involving itself in infrastructure development is, therefore, to identify opportunities where its skills and resources can best be employed to maximize returns within an environment of manageable risk. Government actions to control tariffs or cap profits, therefore, will have a direct impact on the primary objective of the private sector and may make projects unattractive unless well defined.

b) Spreading investment risk

Major companies and organizations in the private sector that have built special capabilities and skills in a particular area are sometimes exposed to investment risk either within the sector or the country in which they operate. In addition, through their successful operation in other areas they may have built large capital reserves which they would wish to employ effectively. These are strong reasons for the private sector to seek to diversify their investments while at the same time focussing on areas where they have proven competence and competitive advantage. Governments may be able to exploit this objective of the private sector by providing suitable investment opportunities.

c) Strategic marketing positioning and creating a vertically integrated operation

The private sector relies heavily on its reputation for successful implementation of projects. While some projects may be less profitable, they can provide an essential introduction to follow-up or downstream activities. Examples include proving their capability of working in third countries or exploring opportunities to broaden investment through the development of infrastructure related to their main area of business, such as provision of office accommodation.
which may be integrated with mass transit rail systems. This approach is closely related to creating a vertically integrated operation in an effort to spread risk and provide an integrated service to customers. Examples exist in the shipping sector where shipping lines have established cargo management units specifically with a view to taking over key ports, inland clearance depots and transport operations. Appropriate packaging of projects, which may provide opportunities to combine public service facilities with more commercial activities, can assist governments in attracting investors to projects which would be only marginal if marketed in isolation.

d) Application of proven management skills and technology

In general the private sector has established a reputation for stronger management due to its ability to recruit and adequately compensate qualified managers and technicians. In addition, through its operation in various parts of the world, the private sector has invested heavily in building experience in developing and applying technology, operating facilities and providing services attuned to the competitive world of global trade. This expertise is seen as a marketable commodity which the private sector would like to see applied in other locations and industries. Governments may be able to attract market leaders to invest in high technology activities.

4.2 The role of the port

Ports can be classified by the type of cargo handled, for example, bulk or container, and by the scale of operation as in India, where ports are classified as major ports if they have handled in excess of 1 million tonnes in any one year of operation. A port can also be classified in terms of its function in relation to its contribution to a wide range of national objectives such as economic growth, national integration, regional development, employment creation etc. This role, as defined by the government, will have a significant bearing on the potential for commercializing the activity or in selecting the best approach to involve the private sector.

An explicit definition of the role of the port, or part of the port, to be privatized creates confidence and helps in establishing the type and level of risk that may be associated in any long term commitments. It therefore directly assists in attracting greater private sector interest in participation, through the formulation of focussed tenders and subsequent offers, and establishes realistic expectations as the basis for negotiations.

Ports or terminals may fit several or perhaps nearly all of the categories listed below, some of which, however, may be conflicting in nature. In such cases it remains necessary for the government to define and prioritize the role and objectives it sets for the ports. This can ensure that the commercialization or privatization programme that is ultimately devised, will be suitably responsive to those various roles.

It is, therefore, essential that the sponsors of privatization clearly define from the outset the role of the port. This is particularly appropriate since sponsor ministries or agencies within government are not always directly involved in trade and transport matters (e.g., in Mexico and to some extent Thailand).
Ports may be classified under the following roles:

a) Public utilities

In many countries, ports can be classified as essential public utilities. That is, they play a direct role in the daily commerce and functioning of society at large. Examples include economies which are dependent upon seaborne imports for a large proportion of their requirements and which lack viable alternative routings. Island states offer the best examples. Others in this category could include coastal or riverine communities with limited inland linkages due perhaps to distance, terrain or hostile neighbours.

Some ports or terminals serving a significant domestic passenger market which lacks alternatives at comparable convenience and cost may also be categorized as public utilities.

Where a facility is designated as a public utility, its economic and social role must be taken into account when considering any change in its status. This is not to suggest that such activities are unsuitable for privatization/commercialization but rather that their role must be considered in defining the optimal approach and, in particular, the ongoing regulatory role of the government.

b) National security

The military presence can be quite significant in ports where commercial shipping and naval vessels share facilities, such as basins, channels, quays or access roads. In such locations the intended role of a port or facility in the event of a declared national emergency may differ significantly from its role in normal times. Even so, a national security role need not necessarily preclude some level of private sector orientation, however, special consideration will be needed in the approach adopted and the contract finally drafted.
c) **Strategic national resource**

A number of governments throughout Asia and the Pacific are adopting national economic strategies or targets. An example is Malaysia’s focus on the export of finished manufactured products, i.e., containerisable goods. A corollary of this policy in Malaysia is to promote direct shipping services in order to capture the maximum amount of value added from such sources as freight forwarding, insurance, banking, etc. Both objectives are to some extent dependent upon the range and quality of port services. The port system in this instance becomes a strategic national resource.

Malaysia has decided that the best way to ensure that ports are supportive of the national goals is to privatize them so as to introduce the performance and efficiencies associated with the private sector. In all such cases, however, the offer and agreement between the public and the private sector are structured to promote the national target within the context of the private sector’s overriding objective of profitability.
Regional economic development catalyst

No national economy is completely homogenous and economic growth in certain regions or areas invariably surpass those of others within the same country (e.g., Guangdong Province, China has witnessed spectacular economic growth which has been encouraged, at least in part, by port development). It is a common practice for governments to channel development funds to the slowly growing regions of the country, so as to accelerate their development. Expansion of basic infrastructure, including ports, is a favoured tactic in attempts to attract industry. In some instances, the employment of large amounts of port labour by itself is considered to represent substantial progress whether or not a trade develops to utilize that labour to the fullest.
In such cases, it is important at the outset to identify whether a port under consideration for privatization intends to, as one of its principal roles, serve as a catalyst for regional development. Where it does, several factors must be addressed.

First, a private entrepreneur, whilst desirous of market development, is unlikely to share with government the objective of regional economic ‘pump priming’ through discounted service charges or other promotional measures which may not be recoverable by the port but would be by the wider economy of the surrounding region. Similarly, the private sector may value the business opportunity on the basis of immediately identifiable and realizable revenues and will bid for a port/terminal accordingly. This bid may prove to be of a lesser amount than the government either invested or anticipated.

Second, whereas the government may desire a certain programme of future expansion in order to satisfy objectives independent of the port scene, the investor may be more cautious about the extent and timing of such future expansions. In addition, the private operator will seek to rationalize staffing levels unless constrained by contractual agreement receiving if it has not completed a commercial evaluation of the investment.
Case Study

Ports as Regional Development Catalysts: Maharashtra State, India

In India, private investors are viewed as essential participants in the drive to expand infrastructure and promote economic growth. In such a large and divergent country several different models have been tried.

The various State Governments have begun to promote development at their intermediate and minor ports (major ports fall under the jurisdiction of central Government) in order to serve as magnets for industrial investment. Several of the maritime states have exhibited a significant commitment to finding port investors and providing a commercial framework for them to operate.

For example, officials of the economically important Maharashtra State, have stated clearly that the State will do everything in its power to ensure that port projects are commercially viable. This intent has been corroborated by Maharashtra’s published guidelines, stating particularly that:

- The period of BOT will be 30 years which can be extended for a further 20 years;
- In respect to selected ports the Government will take equity share up to 11 per cent to reduce the necessary level of private investment;
- The back-up infrastructure of the port will be provided by the Government;
- The company responsible for developing and running the port will have complete freedom in fixing tariffs for all services; and
- The Government shall collect only three rupees (US$ 0.09) per tonne on the cargo handled, a rate which can be no more than doubled every five years.

This approach to partnership between Maharashtra State and the private sector is an important ingredient as many of the projects planned for development are essentially of a “green field” nature, characterized by high development costs and initial, uncertain revenue streams. They are designed as catalysts to encourage industrial development, but the extent and timing of investments is largely beyond the control of sole private port investors. Maharashtra, has clearly shown its understanding of the risks and the need to demonstrate its commitment to success.

e) Commercial activity

In a relatively well balanced economy, it may be possible to classify some or all ports as purely commercial activities. In the case of “common user” ports, this may apply where there is a functioning market which comprises of sufficient options to ensure competitive market forces.
Elsewhere, industry-specific and/or fishing ports may also be defined as purely commercial activities with neither national nor regional development roles.

The United Kingdom ports privatization fits within this scenario with a large number of ports and facilities already competing on a commercial basis and, as a result, the government was able to adopt a fairly straightforward privatization programme.

4.3 Legal restrictions affecting privatization options

Any successful effort to introduce a private sector orientation or private sector participation into ports, inland waterways and dredging must take cognizance of the existing legal framework.

When laws and regulations are identified which may in any way limit available options, governments have two choices. They can design an approach consistent with the current legal structure or they can change it. Either strategy is legitimate, and both have been utilized.

The decision on which strategy is to be adopted will be based on how best to balance the objectives of port privatization and the objectives underlying the existing law. This must be done on a case by case basis. In some instances it has been determined that changing realities mean that the law can be amended or replaced without harm whereas in others the law has stood and the privatization programme tailored to comply. For example: Australia, Malaysia, New Zealand, the Philippines and Republic of Korea have created broader Build-Operate-Transfer (BOT) laws covering all new private financed infrastructure development. By contrast, India and others have, thus far, elected to proceed under existing legislation.
There exists a number of other legal elements which affect the process of privatization within some jurisdictions in Asia and the Pacific. These fall into two broad categories as follows:

a) Ownership or Control Issues
   - Foreign investment or control;
   - Land use and ownership;
   - Duration of leases; and
   - Public/private joint ventures.

b) Management or Operations Issues
Pricing and tariff controls;
Import duties;
Labour; and
Repatriation of funds.

These are examined in more detail below:

a) Ownership or control issues:

Foreign investment or control

Some countries restrict the right of foreign interests to own property. Others limit foreigners' ability to assume controlling interests, at least in enterprises. Transport services such as seaports are sometimes included in this category. For example: in the Philippines, for projects to be implemented through a scheme other than BOT and which requires a public utility franchise, the facility operator must be a Filipino, or if a corporation, must be duly registered with the Securities and Exchange Commission and owned at least sixty (60) per cent by Filipinos,

If domestic investment and operational capability is in sufficient supply, such constraints need not be a significant barrier. If, however, some foreign input is desired, it could still be sought in a minority role (as in the Philippines example above) or under a management contract. China, for one, has adopted an approach employing joint ventures to address this issue.

Land use and ownership

In many locales, land has been set aside specifically for port related purposes. In some instances it has been allocated to specific parties to carry out these port related activities.

Due to various legal restrictions, it is sometimes not possible for a new operator to take possession of the site. This is the case in Malaysia, Thailand and several other countries. In practice this ordinarily presents no real obstacle so long as the "right to use the land" can be transferred. Whilst such a restriction would prohibit outright sale of a facility or site, it would still leave open numerous privatization options such as leasing.

Some observers have argued that the inability to purchase property leaves the investor (or more importantly, the investor’s financier) with no tangible assets. However, the lease and licence to operate are items of value in themselves, and contracts can be drawn up to protect the investors' or lenders' rights.
Regulatory restrictions on the use of a site include zoning designations and many jurisdictions may apply, for example in urbanized areas. In some cases these are protective of the port industry in that they prevent asset stripping and uncontrolled wholesale conversion to other higher value uses as has been experienced in some privatization exercises in the United Kingdom. On the other hand, as transport has become an increasingly integrated activity, thought should, therefore, be given as to whether existing land use designations are too tightly drawn. If so, an aggressive private operator may find himself precluded from introducing ancillary, value-added services (e.g., intermodal transport operations) which, if permitted, would not only
make the port privatization opportunity more attractive, but also contribute to a more efficient regional or national transport system.

Case Studies

Land Ownership: Port Klang, Malaysia

In Malaysia, the site of Port Klang was granted to the central Government by the State of Selangor in which it is located. The transfer was specifically for "port purposes", and the understanding was that the land would be returned to the State if not required for this end.

This is one of the reasons that in its several successful privatization projects to date, Port Klang has chosen to remain the landlord and to lease sites to private operators. "Superstructure" i.e. equipment and buildings, however, have been sold outright to the investors.

The issues of land ownership and of "port purposes" were also raised when BOT development of a Distribution Centre was mooted within the port. The question was resolved with a broad interpretation that such an activity is clearly port-related in the modern-day transport scene. Moreover, Port Klang itself entered into a joint venture agreement with the private developer which ensured its continued public ownership.

Case Study

Land Ownership: India

In India's southern State of Kerala, the Government has sanctioned private development of a new international airport. The State Government was to arrange land acquisition under its statutory power of eminent domain.

Reluctant land owners, however, pointed out that the Government equity participation in the development company does not come to 51 per cent. Therefore, the court ruled that such a company is not Government owned, and Government procedures for acquiring property or land could not apply.

If this precedent stands, it has implications for structuring and implementing future BOT infrastructure projects in India.

Duration of leases

The World Bank has identified the permitted lease period as a key success factor in many proposed port privatizations.

Port investments are frequently large with extended development times and long or even uncertain payback periods. Prospective investors, therefore, ordinarily seek the longest possible
Regulatory restrictions on the use of a site include zoning designations and many jurisdictions may apply, for example in urbanized areas. In some cases these are protective of the port industry in that they prevent asset stripping and uncontrolled wholesale conversion to other higher value uses as has been experienced in some privatization exercises in the United Kingdom. On the other hand, as transport has become an increasingly integrated activity, thought should, therefore, be given as to whether existing land use designations are too tightly drawn. If so, an aggressive private operator may find himself precluded from introducing ancillary, value-added services (e.g., intermodal transport operations) which, if permitted, would not only
authorization to operate. Some legislative environments are supportive of this need whilst others, especially those drawn prior to the onset of infrastructure privatization, may be less sensitive.

In Hong Kong, China, leases have been traditionally granted for 50 years with an assumed automatic right for extension thereafter. Indian port legislation permits a lease of up to 30 years, which is commonly considered a minimum period for a BOT project where up-front investment is high. Other locales, however, are limited by law to leasing government-owned lands for shorter periods. As long as these mandated shorter periods remain in effect, methods of privatization other than BOT, which depend entirely upon private sector funding, may have to be considered.

For example, it is noted that Malaysia's pioneer privatization of Kelang Container Terminal entailed a lease period of 21 years. This, however, was for an already completed, fully equipped and, therefore, functioning operation. Immediate capital investment requirements by the private operator were limited.

Public/private joint venture

One method of privatization which addresses a number of the foregoing as well as the following issues is the creation of a public/private joint venture. When the government, through its port authority or some other public entity, takes a stake in a project, it can sometimes ease conditions of investment magnitude, lease duration and land ownership which could otherwise render a project commercially unattractive to private investors/financiers. A public stake in a project may also facilitate land acquisition, reasonable tariff charges, import of equipment and labour peace. Significantly, it can also alleviate a common apprehension that an activity of national interest (i.e. a trade gateway) is solely in the hands of the private sector.

China has adopted the joint venture approach for its ports, perhaps most notably in Shanghai. On the other hand, India's Major Port Trust Act makes no provision for public/private joint ventures so they are considered forbidden at that nation's 11 major ports. India's state ports, however, have no such restrictions, and several projects are being considered utilizing this approach.

b) Management or operational issues:

General

Legal constraints at the management/operational level may have a different impact on port privatization than those at the ownership/control level. Laws affecting ownership define the parameters within which the privatization programme must be formulated. As there are many paths to privatization, the issues discussed above serve broadly to point the direction of an acceptable route.

Regardless of the approach adopted, however, legal restrictions at a managerial/operational level may determine the commercial viability of a proposed project. Government
sponsors of port privatization should consider carefully the extent to which the following issues prevail and whether they may blunt the interest of prospective investors.

**Pricing and tariff control**

One of the most sensitive issues on both the public and private sides of the negotiating table is the setting and control of tariff levels. Some jurisdictions are legally obliged to hold this power firmly in the public grasp. Investors, however, consider they are investing large sums of money and accept a long-term contract for management and operation of a commercial undertaking without control of the pricing process.

Governments in industrialized countries ordinarily impose no control over port pricing. The Port of Rotterdam, for example, assumes that competition within and between ports will keep tariffs in line with actual costs and that the operators' profit motivation will serve to enhance efficiency and minimize costs.

Asian governments are more inclined to retain pricing control. India for one, however, has recognized that this is a critical issue in crafting a successful privatization programme. The Ministry of Surface Transport has now established an independent port pricing board to review requests for tariff increases. The intention is to remove politics from the process, and provide a clear basis for price setting and to create a forum where economic and commercial factors can be weighed impartially.

Another concern in many locations is the currency in which tariffs are denominated. A large amount of an operator's expenses may be payable abroad (e.g., for capital and interest payments, for equipment purchases and for selected management personnel salaries) whereas local legislation may mandate tariffs in domestic currency. A volatile local currency, therefore, represents a considerable commercial risk. Some jurisdictions have amended regulations in order to permit tariffs to be set in another currency (e.g., US dollars) whilst others have allowed denomination in dollars but payment in the local currency equivalent. Either approach provides some protection to the operator from exchange rate fluctuations.

Any government pursuing port privatization should pay particular attention to the impact of pricing and its control on the attractiveness of privatization projects.

**Import duties on equipment**

Few countries manufacture the full range of capital plant and equipment utilized in a modern port. Even when they do, local production will not necessarily provide the best tool for every task. That is why in the world's leading ports one will find equipment from many manufacturers from around the world.

Many governments in Asia and the Pacific seek private participation in ports because they aspire to world-class transport facilities to support their own growth in trade. Some also seek to capture a larger regional role though, for example, the provision of transhipment services.
Presumably both objectives imply provisions of the very best performance and the commitment from the private sector to provide it.

Conflicting signals emanate, however, when governments impose a penalty on importing state-of-the-art equipment. Import duties on port equipment in some jurisdictions can be onerously high. The result can be that capital costs are magnified to the point that project feasibility suffers. In response, the amount of equipment introduced may be more limited than desired or less highly specialized local pieces may be selected. In either case, there would be a penalty in terms of performance and efficiency.

The easiest way to deal with this potential dilemma is to eliminate import duties on equipment used in expediting export flows. Another approach is to declare the port a free trade area in terms of the import of equipment intended to work solely within its boundaries.

**Labour**

Labour is a particularly volatile issue. All prospective investors are aware that they must comply with national standards as set out in labour and safety legislations. What is more problematic in the port sector of Asia are the practices which have frequently evolved into a quasi-legal "right".

Excessive staffing levels and restrictive job descriptions run counter to modern port management and operations. It is incumbent upon any government which is serious about expediting its export flows and reducing costs to permit private operators to rationalize port labour and practices. However, the investor cannot do this alone, but must have the full support of the public sector.

**Repatriation of profits**

Private ports are purely commercial ventures from the perspective of investors. The objective is to earn a fair and reasonable return on investment or profit. If, however, the profit cannot be repatriated or is the subject of punitive taxes, the commercial appeal for foreign investors will diminish.

This situation is not limited to the ports sector but applies to any foreign investment. Hence it would appear essential that profit repatriation be permitted if foreign investment is sought. Alternatively the privatization programme should target only domestic investors/operators.

**4.4 Ongoing role for the government**

Defining the ongoing role for the government will largely depend on the form of the newly commercialized/privatized entity. Having clearly established the national interests and objectives, project sponsors within government can define appropriate ongoing government
responsibilities which will support the commercial operator. A clear statement of the regulatory environment will directly assist government agencies and prospective investors in establishing effective operational approaches consistent with governmental policy.

The appropriate regulatory framework and the precise role of the enforcing agency should be defined prior to concluding the privatization agreement. This ensures that all is in place to protect the public, and clearly inform the private party of the regulatory environment in which it is expected to operate.

Several options for ongoing governmental participation are outlined below:

a) Competitor

A public sector terminal or port continuing to operate post privatization as a competitor to a private operation may raise several sensitive issues. For one, labour interests at public sector operation may object to performance comparisons with private terminals. They may also argue for pay and bonus schemes similar to those enjoyed by their privately employed counterparts yet without giving up other benefits of tenure.

Public port authorities deliberately promote competition to ensure no private monopolistic practices develop. It is also sometimes argued that a continued public operating role provides a benchmark to check on the performance of the private operator in terms of operating productivity and cost.

However, private investors may have valid concerns about low-priced competition which is bankrolled by government and which may not have to earn a return on investment, either due to budgetary support or to the fact that existing facilities have already been largely amortized. Some private port operators have stated they choose not to invest in locations where they will compete directly with publicly operated terminals.

Obviously, competition within a single port raises more of the foregoing issues than does competition involving physically distant public and private operations. In either case, however, the prospect of public-private competition must be addressed as it affects the attractiveness of the project.

b) Active partner/shareholder

Depending upon the approach and extent of private sector involvement, the government may wish to remain an active participant in the project under consideration. For example, the primary thrust may be to invite outside operational expertise, perhaps for only a limited period, or to secure needed supplementary investment funds. Various corporatization/commercialization approaches may be more suitable than privatization in this context. If operational expertise alone is sought, a management contract may prove sufficient. For financial participation, a joint venture might be the preferred choice.
c) **Holder of golden share**

Many governments considering privatization (e.g., Singapore) have determined that it is important to retain a "Golden Share", which provides the right to cast a controlling vote or final veto to protect essential interests such as national security.

If shares in an enterprise are to be floated for widespread public purchase on the stock exchange, such a Golden Share may in fact be reassuring to investors that would assume, at least in the early stages of commercial operation, that the government would not let the private enterprise collapse. If shareholdings are to be more limited, however, perhaps through a small number of investors, then they may be wary of potential decisions made by government on political rather than commercial grounds. The extent of governmental powers retained via the Golden Share should, therefore, be well defined.

In all cases where government retains any shareholdings and consequent representation on the Board of the enterprise, governmental board members should deliberate and vote only with a “commercial” orientation. Routine policy and regulatory matters should not be the province of board members representing government but should rather be the responsibility of external controlling bodies e.g., the landlord port authority or regulatory agency.

d) **Landlord**

Frequently, legislative or constitutional language precludes outright sale of public assets such as ports to the private sector. In these cases, private sector participation may be brought about through a lease arrangement. As in all leases, the owner must prepare a carefully thought out and properly worded document to protect his property whilst not unduly constraining commercial appeal. The ongoing relationship between landlord and lessee over the duration of the lease should be clearly stipulated.

e) **Planner and/or developer**

There are two extremes relating to the role of government in planning the ports and waterways which are ultimately to be privately operated. One extreme is illustrated by India's northwestern coastal state of Gujarat which is an increasingly popular location for waterfront industrial development. There the Maritime Board of the state, to a large extent, responds to initiatives from prospective developers rather than preparing its own overall plan. At the other extreme is Hong Kong, China, where the government undertakes ongoing and detailed planning for the port (albeit with input from private operators and users). The actual implementation of that plan (construction and operation), however, is then left entirely to the private sector. Although appreciating flexibility, many private sector sources indicate a preference to have at least an indicative plan in place to assist them in tailoring their proposals to future perceived needs rather than have each project evaluated on an ad-hoc basis.

In terms of public development, in locations where project financing is not the primary objective of privatization, the government sometimes supplies facilities consistent with its plan
and then turns them over to the private sector for lease and operation. Malaysia's Port Klang developed its new Westport complex in this way prior to privatization. Rotterdam Port in the Netherlands routinely provides channel, basin and quay walls before leasing out the back up area for private development.

In all ports, the efficient operation of cargo receipt and dispatch is not limited solely to waterfront terminal facilities. Channels, anchorages, navigation aids and sometimes breakwaters are required on the waterside. Inland there is a need for road and rail access, supporting marshalling areas, ICD's etc. Most of these investments ordinarily fall outside the scope of the port privatization agreement and many remain as public sector responsibilities. Such essential ancillary facilities have a direct impact on the commercial attractiveness of the port itself, and many prospective port investors will look for a recognition of this fact on the part of government and a commitment to provide them on an agreed schedule. Governmental adherence to this commitment and to long term strategic planning across the transport sector is, to many, a measure of its commitment to the overall success of its commercialization programme.

f) Support or common services

Similar to the foregoing, if a port is to be privatized in parts rather than as a whole, a number of common services remain the responsibility of the landlord. These may include provision and maintenance of access channels for shipping, of pilotage and towage services, of internal port circulation roads, of security and fire protection. Such services may themselves be contracted out but their provision would ordinarily remain the responsibility of the landlord. The lease agreement or other privatization contract should spell out these residual support or common service responsibilities of the landlord/government.

g) Policy maker

The government will want to maintain a policy role in the sector in cases where it judges ports and waterways to be of critical national importance. The exercise of this policy making prerogative should largely precede privatization in order that contracts with the private sector can reflect the public priorities. Prospective investors will also need to be apprised of the potential future implications of policy execution. As in the discussion of "Golden Shares" above, governmental board members of the privatized entity should not be seen as the implementors of new policies. Rather, requisite changes should be negotiated at the level of the contracting parties, e.g., landlord and tenant.

h) Regulator

In any privatized port, there will be an ongoing regulatory function. This is to ensure compliance with safety and environmental rules and with enforcement of contractual conditions (e.g., performance standards). Adherence to policy guidelines, where they exist, must also be regulated.
i) Marketer

Some private operators in ports welcome governmental support through marketing and promotion of the port as a whole, whilst others judge it to have only minimal impact. In part, the government's decision on whether it wishes to maintain a marketing posture is dependent upon its perception as to the national importance of the port facility or activity to be privatized and upon its judgement whether, through its contract with the private operator, it can achieve all the results it seeks.

The Municipality of Rotterdam considers the port of such importance to the local and national economy that it is not content to leave the marketing function solely to its private tenants. Rather, the landlord engages in extensive marketing and public relations efforts to promote the port as a whole. It also assists its tenants and contractors in marketing individual terminals or services.

4.5 The role of the private sector

Under the broad umbrella of commercialization/privatization, the government has many options as to how it will introduce and nurture a commercial perspective. In some instances, the preferred approach will be dictated by the answers to earlier queries concerning the significance of the asset to be privatized. In other cases, existing laws may preclude certain approaches to private sector involvement.

Even where policy and law permit a broad range of options as to the private sector role, some may be more publicly and/or commercially appropriate for a particular project. The decision as to the private sector's role will flow directly from the preceding discussion concerning the ongoing role of government in the ports and waterways sector.

Some of the possible roles of the private sector are illustrated below:

a) Owner

Ownership provides the highest degree of control and flexibility to the entrepreneur and for this reason it is often viewed as the most attractive approach. At the same time, full ownership represents the most expensive entry into the market and may push a project beyond the grasp of even financially strong interests. There may also be legal constraints which preclude 100 per cent ownership. Perhaps the best examples of the transfer of port ownership has been in the United Kingdom where the government sold entire port complexes to the private sector in almost the same way as any ongoing commercial undertaking.

b) Partner

Where there are obstacles to full private ownership or where the government decides it wishes to retain a role, some form of partnership (e.g., Joint Venture) may be appropriate. China,
for example, has decided port projects should be in the form of joint ventures with majority control (51%) held by the public sector. In many ways, the partnership approach requires even more detailed effort and negotiation prior to finalizing an agreement. Both parties will want to ensure that the limits of responsibility and liability are fully defined with a clear distinction of the responsibilities and authority. Management of the enterprise and its autonomy will require special attention as will valuation of assets and partner inputs in terms of the initial investments. Some private investors are reluctant to proceed in the absence of a controlling share particularly as the longer term impact of government led concerns are difficult for the private sector to project and plan for in terms of risk minimization.

c) Lessee

The port or terminal, whether fully private or a joint venture, may be leased from the formal owner. Leases should address not only payment, land control, etc., but also the responsibilities of the tenant (e.g., performance standards) and of the landlord (e.g., for provision of supporting services and/or office infrastructure).

d) Manager

In some cases, the government's primary objective may be to improve efficiency and operational performance in its ports. Private sector involvement could then be limited to recruitment of port-specific management expertise. In most instances, for this external management capability to be introduced and to be effective, some changes would be required in governmental procedures and procurement/recruitment practices.

One method of bringing in experienced port operators/managers might be to turn to existing employees of domestic stevedoring companies or shipping lines, or local representatives of foreign shipping lines. This, however, would probably entail alterations to civil service staff regulations. Another approach could include recruitment of experienced managers from home or abroad on a consultancy basis to work alongside existing management.

A climate for change must exist both within the port and the government for this approach to prove effective. After all, the prevalence of barriers to success are seldom limited to the people occupying positions today. More likely it is the rigid framework in which they function which prevents better results. This has been borne out in many of the successful privatization programmes in which the same management team, that was employed by government, have continued to manage and operate the port after its transformation.

Another approach is to sign a management contract with a reputable firm to take over the operations of the port or a particular terminal for a specified period. The contract should be of sufficient duration, say three to five years, to permit the professional operators time to alter entrenched practices and to make an impact. Such an approach can free the operator from government set wage levels and allow staff to be adequately rewarded for skill and responsibility. However, flexibility on the part of government and existing port management would be required if a true commercial orientation is to be established.
Following the contractual period of the management contract the public sector has the option of resuming management control of operations. Presumably procedures and practices would have been institutionalized to the degree that they can be maintained by regular staff so that the efficiency gains can be perpetuated.

It should be noted that recruitment of management expertise under any of these options entails the port paying rather than receiving fees from the private sector. It may, however, be possible to negotiate terms with incentive bonuses or a sharing of increased business/profit.

e) Operator

Any of the previous categories could also include the private party performing the function of an operator. In a pure operations contract or a lease of existing port facilities, the issue of investment and level of investment should be addressed as this will have significant implications for contract duration. In particular it will be necessary to stipulate whether the private sector operator utilize port equipment (and/or equipment operators/drivers) or provide his own. Also at the time of capacity expansion will the operator finance new equipment and/or added berths or storage areas? Many countries have experience with this type of contract, for example, through the involvement of private stevedores in public ports, the maintenance of equipment, provision of security or even catering services in some cases the operator or provider of services are paid a fee by the port. In others, the operator pays for the right to utilize the facilities of the port in providing revenue paying services to others.

f) Physical developer

As already noted, in some ports the government or current port management invest in facilities whilst in others this responsibility is transferred to the private sector. Of particular importance is the question of who will fund future capacity expansions as they become necessary. The responsibility and the schedule (e.g., based on level of utilization of existing capacity) should be well defined prior to contract negotiations. If this is not the case, there is the risk that the party charged with funding the expansion not agreeing with the other party as to its need and timing. For example, the government may wish the private operator to expand capacity in order to minimize berth occupancy levels whereas the operator holding at least a semi-monopoly may prefer to postpone investment and to maximize returns even if at the expense of ship queuing and the loss of some discretionary traffic. On the other hand, if expansion is the government's responsibility, the private operator may be frustrated that channel deepening, berth extension or inland linkages are delayed at the cost of commercial opportunities. Central to this issue is the sharing of risks and benefits.

g) Market developer

The government may invite the private sector to participate in port activities with the object of attracting new businesses. If market development is a target, performance standards can be assigned addressing market enhancement indicators (e.g., pricing, productivity, berth
occupancy, security from pilferage etc.). Throughput guarantees over the period of the contract can also be mandated with bonuses or fines if they are not achieved without sufficient reason.

4.6 Criteria for selection of the private party

Private parties interested in port privatization frequently find themselves frustrated by their inability to ascertain the criteria on which their proposal will be evaluated. They feel this makes it difficult for them to judge their own competitiveness in relation to a particular opportunity and to present their strongest case including the packaging of their bid.

The absence of clearly defined criteria in advance can also greatly complicate the work of the selection committee. On more than one occasion, lack of specificity has resulted in political and legal challenges to the recommended award. The resultant controversy not only delays the process, it may adversely impact on the reputation of the civil servants involved and raise questions about the merits of the privatization programme itself.

Criteria should, therefore, be carefully considered, and publicized in advance. They may, inter alia, include the following:

a) Cargo contribution

In the interest of attracting additional throughput, some governments favour the involvement of shipping lines in the private sector team to take over a port or terminal. The expectation is that as an investor, the line will make every effort to direct traffic to its own facility. The same logic can be applied to major regional shippers. Port users (both lines and shippers) have obvious interests in the performance of the port and are often prepared to invest in order to protect their core activities, simultaneously enhancing their competitive positions.

It must be recognized, however, that the shipping industry is highly competitive. Any perception that a line investing in a terminal might favour its own vessels at the expense of competitors could discourage other lines from calling at the terminal. The Philippine Ports Authority (PPA) was forced to confront this issue when seeking to privatize its domestic inter-island terminals. The major carriers were the obvious candidates, but PPA did not wish to squeeze out the smaller providers of shipping services. Wherever there are limited berthing options available, the assurance of "even-handed" treatment of all users is paramount. Some port authorities have allowed lines, individually or in consortia, to lease berths but have provided a common user capacity under public management/operation or through an independent contractor at neighbouring terminals.

b) Port management expertise

The most frequent criterion for prospective port privatization is that the candidates include proven expertise and experience in port management.
c) Other transport expertise

On occasion, governments have accepted expertise in related transport sectors (e.g., shipping or rail or road haulage) in lieu of specific port management credentials. This may be particularly applicable where the desire is to privatize to local interests, even though the track record of domestic companies in the ports sector may be limited.

d) General management expertise

In instances where an entire port is to be privatized, it may be reasonable to expect that most of the existing management team will shift to employment with the private operator. This might be deemed as sufficient to ensure that hands-on port sector expertise is available to complement the skills of a private sector general management company. The key consideration would be to introduce a commercial orientation.

e) International expertise

Especially because upgrading of efficiency is often an objective of privatization, international participation in the private enterprise, at least in the short to medium term, is frequently favoured. Almost all ports are by definition involved in international trade. It is important for domestic economic interests that facilities and performance be commensurate with the ports of trading partners as well as with those of competitor nations.

f) Maximum domestic participation

Ports are widely considered to be important national assets. Some governments, therefore, prefer achieving the maximum level of domestic participation in their privatization programmes. In these cases, targets on foreign/domestic ratios should be clearly indicated when inviting bids.

g) Participation of management and employees

The United Kingdom, in its privatization of Trust Ports, introduced through weighting of bids a preference for Management-Employee Buy-Outs (MEBO). At least two of the Trust Ports have been privatized in this manner.

The MEBO approach is attractive in that it ensures current expertise to remain with the port and provides an opportunity for reward for those who have made the port what it is today. It also ensures a future incentive to excel, as the staff will be both the owners and the beneficiaries of any improvements.

Some observers argue that if the primary objective is to improve performance, it is unreasonable to turn the port over to those who have had the opportunity in the past but have thus
far failed to satisfy the government's quest for productivity. Although valid to some extent, this criticism overlooks the fact that management and employees have in the past been functioning in a public sector environment and have not had the opportunity to prove their skills in a wholly commercial setting. The key question, therefore, in evaluating whether a MEBO may be appropriate is to consider the capabilities of the current staff, particularly the entrepreneurial qualities of top management leading the MEBO effort.

A crucial point is that port managers and employees can only rarely generate the substantial amounts of equity investment needed for a port privatization and still retain controlling interest. If the government's objective in privatization process is to maximize its return, a MEBO is unlikely to be the chosen approach. If a MEBO is given substantial preference in evaluating competing bids, some minimum time limit for retention of shares and ownership should be considered to avoid the reaping of windfall profits by members of the MEBO team by selling the port to a secondary buyer.

h) Highest return

In the case of some port privatization initiatives (e.g., Argentina and Hong Kong, China), sale has been to the highest bidder. This approach maximizes the return to the government and serves to avoid controversy as no subjective judgement is required. However, the port may have many important contributions to make to the nation which are not necessarily addressed by selecting a bid based on the financial figure alone. If the highest bidder is to be awarded the facility, it is highly recommended that a very rigorous screening procedure be imposed to short-list only those entities that have clearly demonstrated an understanding and conformity with government objectives to bid. This short-listing could include any or all of the potential criteria described above.

4.7 Protection of the investor/operator

Investors are invited to participate in the port sector because government has decided it is in the public interest that the activity take place in a more commercial environment and be less constrained by government control. It may also be that it is anticipated that the private sector will supplement limited public sector resources, install more efficient management systems, attract additional cargo (e.g., from a shipping line investor). For each of these areas of potential benefit to the public sector, government will need to define measures of success which will be written into the contract with the private sector.

Some governments have deemed it appropriate to provide certain safeguards for investors (e.g., Hong Kong, China with its "trigger point" mechanism ensures no oversupply of container terminal capacity). In other locales, especially in the case of privately generated proposals, prospective investors will usually propose a particular set of supports or guarantees which they consider appropriate to ensure no more than a reasonable level of risk. Some governments have declined to interfere at all in the market, placing the entire risk on the private sector.
Obviously the level of risk to be borne by all parties is a key factor in determining the attractiveness of a particular project. In order to adequately compare competing bids, it is wise for government to establish and communicate the level of safeguards and level of operational flexibility in advance. These may include:

a) **Financial guarantees**

In some transport sector privatization initiatives, governments have guaranteed a minimum return on investment. This guarantee may be through direct subsidies by government in the event of revenue shortfalls, or guaranteed throughput or traffic levels. Such measures have been more frequently applied in the case of passenger transport, i.e., highways and mass transit systems than in ports;

b) **Commitments to develop supporting infrastructure**

As already noted elsewhere, a critical component of success will often be the availability of supporting facilities or services outside the privatized facility. Government commitment either to provide or to ensure provision of such elements constitutes an important risk protection for the private investor;

c) **Limitations on competition**

The limit in Hong Kong, China on competition by permitting new expansion of capacity only when previously established volumes and growth rates have been achieved has already been noted. This is a major protection measure, particularly in a growing market, which has found ready acceptance by the financial community which, as lenders, feel their loans are well secured.

Another approach to limiting competition is for investors to negotiate “first right of refusal” to undertake all relevant capacity expansion, e.g., container terminals.

d) **Freedom to diversify**

Many public ports are narrowly limited by their enabling legislation as to the activities they can undertake. Private operators on the other hand may seek the right to diversify and to add services which increase their revenue base or their competitive position.

Examples may include, establishment of inland container depots and distribution centres, inauguration of road haulage services, operation of unit trains, development of feeder shipping lines, etc. All of these activities can serve to provide a more effective and integrated transport network. This approach, however, should be weighed by government in light of any monopolistic tendencies which may emerge. Nevertheless, there appears to be no reason to ban the opportunity arbitrarily;
e) Freedom to sell or subcontract services

The primary interest of the government is the achievement of its objectives. As long as performance standards are met, there need be no barrier to the transfer of some service obligations by the primary contractor to another party. This approach may allow the private operator to provide better service at lower cost by involving specialists, while at the same time sharing the level of risk with others. To guard against windfall profits which may be earned by the initial private operator through an early sale of the facility, a “clawback” arrangement can be written into the agreement;

f) Freedom to abandon services

It is conceivable that shifting market forces will render unprofitable a heretofore viable service. In a purely commercial setting, the operator would then alter or abandon the activity. Provision should be made for consultation prior to major reductions in service levels (or increases in price) in such circumstances, but approval for such requests should not be unreasonably withheld. If the service is one that the government wishes to continue, though clearly unprofitable, it can provide support for continued operation.

g) Disposal or conversion of port lands

Most leases stipulate permitted land uses and may prohibit transfer to third parties. In the United Kingdom, the United States of America and elsewhere, however, much of the urban waterfront has found a better market for housing/commercial/recreational development than for continued port usage.

The deciding factor as to whether conversion should be considered depends upon the identified role of the particular port and on the objective of its privatization. As long as the agreed-upon services are provided, flexibility for the owner/lessee/operator insures responsiveness to the market. By converting land from one transport use to another (e.g., an on-dock rail yard to a CFS) enhanced transport services may be offered. By developing non-transport activities in areas which are sub-optimal for port activities, it may be possible to finance expansion of more modern facilities elsewhere.

4.8 Protection of port users

Whilst a case may be made for some level of protection for investors, protection for port and terminal users is also frequently sought. This is the case in some (but not all) instances where privatization of a port facility has the potential to grant monopoly power to a commercial operator.

In the case of existing facilities, where a private operator decides to exploit a monopoly position, the commercial competitiveness of established port users is likely to be adversely
affected. In the same way it is conceivable that realization of national objectives related to trade promotion could be jeopardize and impact on a large part of the community.

It is important that the government be explicit as to the level of protection it will introduce for port users. (The decision will be shaped by the response to the earlier query concerning the role of the port.) A clear statement is necessary for several reasons:

a) to reassure current and prospective users, thereby avoiding public opposition to privatization;

b) to inform prospective bidders, so that the parameters of the opportunity are clear and the proposal can be properly priced; and

c) to establish the foundation for the government's future regulatory framework.

In some locations where government has chosen privatization as the preferred option, there may be some essential services within the overall package (e.g. ferry terminals) which are economically marginal or non-remunerative but which the government considers should continue to operate. Such services should be identified at the outset and will be factored into the agreed price. The contract should stipulate the level of service which will continue to be provided by the private operator.

4.9 Protection of port labour

Worldwide, one of the most challenging and contentious issues faced by governments considering port privatization is the future of port labour. This situation results from the fact that taking into account the currently available technologies, most public ports are overstaffed and, in many countries, alternative employment opportunities are limited. A number of different approaches have been considered and several have been implemented with varying degrees of success.

The situation confronted by labour is, of course, quite different from country to country and even port to port depending upon a wide range of social and economic factors. In some settings sufficient economic alternatives exist and early retirement or "golden handshakes" have been welcomed. In other places where employment in the port is not only prestigious and well paid but also provides guaranteed employment opportunities for future generations of the family, it is not surprising that such offers have meet with little response.

In Malaysia, guarantees of "the same or better conditions" for a minimum period of five years after transfer to the private sector have met with majority labour acceptance whereas elsewhere (e.g., India and Pakistan) there is considerable scepticism that this period of commitment would suffice. In still other locations (e.g., United Kingdom) little specific protection has been offered, however, existing social safety nets were already in place.
Definition of safeguards, if any, for labour and the responsible party for meeting the financial cost must be addressed at the earliest stages of discussion in the privatization process since:

a) it directly affects the political acceptability of the privatization initiative;

b) it directly affects associated costs to government if it is to bear the cost of redundancy/relocation/retraining programmes; and

c) it directly affects the possible cost to prospective private investors if they must either employ all existing labour or pay for some resolution to overstaffing.

4.10 Available options for privatization/commercialization

There is now sufficient worldwide experience in privatization and commercialization in all sectors to illustrate that there are numerous approaches which, under the right circumstances, will be successful. The optimal approach will reflect the policy and legal setting and the unique characteristics of the particular opportunity on offer. The preceding sections of this guideline are intended to provide useful tools for defining a project’s unique characteristics.

Having defined the objectives sought through the privatization/commercialization process, the role of the port or terminal, and the level of various safeguards considered appropriate, the government can examine and select the vehicle which it considers most appropriate.

The activity commonly labelled "privatization" actually encompasses a broad range of options with many variations, each with options for public and private sector participation and control as illustrated below:

Figure 1. Spectrum of commercialization/privatization options

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<tr>
<th>Maximum Public Sector Participation</th>
<th>Maximum Private Sector Participation</th>
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<tbody>
<tr>
<td>Traditionally Publicly Owned and Operated</td>
<td>Commercialization Corporatization Privatization</td>
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The following options for commercialization/privatization are listed in the order of reducing public sector control and increasing private sector orientation. While the spectrum of approaches shown above are dealt with as individual options, combinations are possible such as a lease contract for existing facilities which incorporates provisions for expansion through Build-
Operate-Transfer (e.g., ICTSI in Manila) or formation of a joint venture which includes both lease and B.O.T. elements (e.g., the Port Authority and Hutchison Whampoa in Shanghai):

a) Commercialization

Under the commercialization approach, the government organization concerned, in this case the port entity, remains under public sector ownership, management and operation. Commercialization strategies, however, seek to introduce into the public port management practices which are typical of the private sector. This would include working toward more clearly defined, quantified and integrated objectives measures in operational and financial terms. The services would then be provided within a commercial framework with the objectives of, at least, recovering the full cost of the operation and perhaps making a profit to finance development.

Commercialization ordinarily requires a change of mindset, both for the public servant port managers and for their parent ministries. The key attributes of a successfully commercialized port management include:

- objectives (defined and quantified in operational and financial terms);
- autonomy (i.e., independence and authority); and
- responsibility (for success or failure).

Commercialization is often adopted as a transition towards greater private sector involvement in the provision and management of government commercial activities and services. The "streamlining" in procedures and costs which result from commercialization produce a more marketable product if subsequent privatization is planned. Even as an end in itself, however, commercialization can be expected to result in an enhanced focus on service, efficiency and cost-effectiveness.

One example of commercialization is the operation of "trading funds" which are basically accounting frame-works established by legislation that enable government departments or organizations to provide services on a commercial or quasi-commercial basis. Trading funds have been widely applied in the United Kingdom following the enactment of the Trading Fund Act in 1973. A trading fund differs from conventional government accounting methods in that it is financially performance oriented rather than resource consumption oriented. It also allows cash balances to be retained or ploughed back into the operation. Additionally, the management of the trading fund is allowed independently to raise loans up to a pre-determined level although not granted the same degree of freedom as a financially independent corporation. The trading fund system may be appropriate for the following government activities:

Core services on a partial or full cost recovery basis

Trading funds can be established where a large scale operation is able to recover a significant proportion of its costs by charging users (customers), for example: postal and tele-
communication services as well as port operations. Financial objectives would be set by the responsible policy ministries which also address specific pricing provisions;

**Government support services where a charge can be raised for the service provided**

In this case, the decision to establish a trading fund would be to promote one or more of the following:

- More economical use of the service, particularly where no charge has previously been raised;
- Greater efficiency, by exposing the service to competition or to proxy competitive pressure through price comparisons and cost consciousness on the part of users; and
- Re-orientation of the service to a customer-led rather than producer-driven organization and culture.

In the Asia-Pacific region, a similar framework was introduced in Hong Kong, China following the enactment of the Trading Funds Ordinance in March 1993. At that time it was considered an innovation since Hong Kong, China had, hitherto, operated a centralized cash account system.

The Hong Kong Marine Department is one of the departments of government to which the trading fund approach has been applied;

b) **Service contract**

Service contracts may be used to reduce port investment requirements, to avoid adding to the public sector payroll or to obtain operational efficiencies of the private sector. Entering into a service contract does not alter the status of public ownership or management of the port.

Common examples are contracts with the private sector to maintain port equipment or to provide towage services to the port which, in turn, offers them to the port users. Other areas where service contracts may be appropriate include port security and fire protection.

If the private sector is to provide services directly to the port users then some form of licensing or operating agreement is used. For example, licensing of stevedoring companies is commonly used to provide cargo handling labour in a number of ports in the Asia-Pacific region;

c) **Management contract**

Management contracts establish a commercial relationship between the public port owner and a private sector management team. The contract may cover the entire port or a specialized terminal, e.g., for containers. Under a management contract, the public body retains ownership
and the responsibility to set policy, employ port staff and make necessary investments. (The contractor may, however, be required under the terms of the agreement to provide some items of mobile equipment.) The private manager provides management expertise, supervision and perhaps training, consistent with the programme designated by the owner. Compensation for the contractor may, in part, be geared to performance targets.

Management contracts may prove useful when local manpower is limited (e.g., in some parts of the Middle East) or when inaugurating a new operation. In this latter category, the Port of Johor, Malaysia employed a management contractor to run its container terminal. Once operating procedures were in place and labour was fully trained, it was not necessary to renew the contract as the then public port could proceed on its own;

d) Corporatization

Corporatization occurs when a port is transformed from its statutory role as a governmental department or a quasi-independent entity subject to the conditions of a Ports Act to a fully commercialized but government-owned body under some form of national legislation such as a Companies Act. The levels of independence from day-to-day bureaucratic intervention and of financial freedom (and responsibility) are ordinarily dramatically enhanced by such a move.

It must be recognized that establishing a public governmental organization as a state-owned corporation does not always imply nor convey to that body the full operational characteristics of a private enterprise company. A state-owned corporation means the governmental entity is detached with some autonomy from its parent organization (e.g., Ministry of Transport) and as an independent organization, it is usually responsible for its own financial resources and administrative decisions within its enabling legislation. In many cases, however, the corporation is still regarded as a public governmental organization and is subject to the political constraints inherent with government agencies although its employees are generally not regarded as being civil servants.

There are a number of government owned corporations in the ESCAP region. Among them are the dredging corporations, such as the Shanghai Dredging Corporation, established in the People's Republic of China which, in addition to undertaking dredging operations for the port authorities at pre-determined fees, also bids for and undertakes dredging work overseas in competition with private companies.

The Government of Indonesia, in line with the thinking of a number of countries, for example Pakistan and Malaysia, has taken steps to recreate the four Indonesian Port groups as state owned corporations. They are self-financing with a level of autonomy in hiring of employees, setting salaries and budgeting. Effective 1 December 1992, their legal status was changed to a shared-corporation. The new status provides the basis for changes because, as at least 51 per cent state-owned corporations, they are regulated under INPRES No. 5 of 1988 of the laws of Indonesia. The implementation of Minister of Finance Decree No 740/KMK.0/1989 which sets some performance standards for such corporations, defines the process for the sale of their shares and generally defines the terms "joint operations" and "management contract" to
allow the working together of a corporation with a private party. This ability to enter into joint ventures can be an important tool for future operations and development which has not always been available to public port authorities;

e) Joint venture

A joint venture is the establishment of an operating company owned by a government entity, in this case the port and a private sector company (including foreign company if permitted by legislation) to construct, manage and/or provide port infrastructure and services within the enabling legislation. The governmental entity may invest by way of cash, assets, land or right to use of the foreshore as its share of equity in the joint-venture company. The private sector company may invest through financing and in up-grading the facility or new equipment as well as the provision of technical and managerial expertise.

New policies and regulations promulgated in China since 1985 have enabled the Nanjing Port Authority to establish the Nanjing International Containing Handling Company Ltd., a joint venture company, with an American partner, similarly the Tianjin Port Authority has established a joint venture with a Norwegian Company to operate and improve a conventional terminal.

As mentioned earlier the Shanghai Port Authority has also entered into a joint venture with a company from Hong Kong, China to upgrade and operate container terminals in the port. The joint venture company, namely the Shanghai Container Terminal Co. Ltd., is the largest of its kind in China and came into operation in August 1993. The period of the joint venture is 50 years.

Joint ventures are in many instances attractive to both the public and the private sector for a number of reasons. For the public sector, they ensure a continued and sometimes controlling interest in management and operations as well as share of anticipated profits while importing desired managerial and investment inputs. For the private party, joint ventures can indicate a governmental commitment to nourishing a successful enterprise as well as reducing the level of investment and risk.

A significant factor in the commercial appeal of joint ventures is often whether or not the private partner is permitted to hold the majority stake. A number of prominent private port investors/operators in the Asia-Pacific region have been adamant that they require majority control in order to ensure a commercial orientation and to protect their investments from potentially shifting political attitudes. When China decided, however, that ports constitute a critical national economic resource and that private positions would be limited to a maximum of 49 per cent, they still found some private interest;

f) Leasing

Leasing generally provides for the full transfer of specified assets from a port or its parent ministry to a private sector operator for an agreed period of time. For example, the port may
lease facilities and equipment to the private sector to be used in the provision of specific services to port users.

As part of a lease, some assets may be transferred on a permanent basis through sales/purchase agreements and or lease/purchase agreements or on a permanent basis through capital leases with contract periods which extend over the economic life of the asset. Permanent transfers are generally limited to mobile assets.

Fixed facilities may be transferred by lease for a period of 5-20 years or more. Land to be developed by the lessor is usually transferred for a period of 15-30 years. Longer agreements encourage the private party to make more significant investments and to take other steps to build up the business. Shorter agreements provide the port with the ability to adapt to changes in the market, to allocate resources to those businesses which are most important to its future, and to choose those private parties which are most effective in conducting these businesses.

It should be noted that:

If the assets transferred to the private sector are constrained in their use to a specific function or service, then the value of the assets is dependent upon that function or service. If they are transferred without restriction, then their value is associated with the optimum use of the assets and the revenue streams that they can generate. For example, if a mobile crane is transferred to the private sector under a sales/purchase agreement, then its value is equal to the price of the crane in the second-hand market. If the same crane is transferred under a lease agreement for use in terminal operations, then its value is either the marginal savings in operating costs to the terminal operator from having this equipment or, if the equipment is essential, the cost to the terminal operator of providing a similar piece of equipment.

Similarly, if land is transferred to the private sector without restriction on its use, either through a long-term lease or a sales/purchase agreement, then its opportunity value is the price which would be obtained from the highest bidder. If the land is leased for use in providing a specific service, e.g. a container terminal, then the value to the bidder will be limited to its revenue potential for the designated use or by the cost of land elsewhere which would provide a similar opportunity.

**g) Privatization**

While "privatization" is frequently employed as a generic term covering the full spectrum of options for greater private sector participation, i.e., commercial orientation, the literal meaning of privatization is the actual transfer of ownership of all or certain parts of a port’s existing land, infrastructure and/or equipment to the private sector to own in perpetuity.

True privatization, therefore, involves a transfer of deed of title from the public sector to a private undertaking. This could be accomplished through outright sale, perhaps to the highest or most qualified bidder (e.g., as in the United Kingdom) or through public flotation of shares in a previously corporatized port as planned by Johor and Penang in Malaysia (although an underlying lease on the land will remain).
It is important to recognize that since full privatization entails a shift of real ownership, any ongoing governmental role or policy considerations must be dealt with in the terms of sale or through regulatory mechanisms. A potential investor, therefore, will be keen to know the existing and future regulatory climate within which he is expected to operate as that will affect the value of the opportunity. Any perceived constraints (or the absence thereof) through deed restrictions or land use regulations will affect the price to be paid by the private investor. The absence of any restrictions may generate a certain price while limitations on the cargo handling functions may generate another and a severe regulatory climate on flexibility, diversification or expansion yet a third.

For example, the market value of waterfront land in San Francisco leapt enormously when restrictions limiting its use to port activities were lifted. This enabled port owners to turn to lucrative urban commercial and property development activities instead. Similar developments could happen in parts of Singapore if urban waterfront areas were open to "highest and best use" as defined by the property market. In the United Kingdom this was the unintended outcome of some port privatization as the owners converted traditional port lands to commercial, residential or recreational uses; and

h) Build-operate-transfer/build-own-operate

All of the foregoing options could apply to exiting assets owned by the public sector. When investment in new infrastructure facilities such as ports or terminals is sought by the public sector, the mechanism is Build-Operate-Transfer (B.O.T.) or Build-Own-Operate (B.O.O.) may be applied.

This approach requires the private party to make major investments in both infrastructure and equipment to create, for example, an operational container terminal from a “green field site”.

B.O.T. is used where the cost of constructing the facility is of primary consideration to the government and implies that the facility would revert to government at some future date for its operation or re-allocation to the existing or another private sector party to manage and operate. B.O.O. suggests ownership in perpetuity by the developer.

All of Hong Kong, China's dedicated container terminals have been constructed under the B.O.O. format.

B.O.T. is currently a favoured approach by many Asia-Pacific governments for new infrastructure development although relatively few completed projects can be cited in the ports sector. The high capital costs of port and terminal development, especially in a greenfield setting, and the relatively lengthy payback periods constitute a substantial commercial risk in many locations that lack market growth or proven track record. Creating conditions to enhance commercial confidence is important for a government seeking investors/developers through this method. One way that Hong Kong, China has achieved this is through regulating expansion of capacity supply in line with the growth of demand thereby ensuring against overcapacity and excessive competition. Shanghai Port entered into a joint venture with a B.O.T. developer for new container facilities thereby eliminating the cost of the private sector having to acquire land as well as bringing political comfort to the venture.