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GOVERNANCE OF STATE-OWNED ENTERPRISES IN THE MENA REGION:

Synthesis and Cross-cutting Findings of SOE Governance Reviews of Six Countries



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ACRONYMS

ACRONYM	MEANING
AMOC	Alexandria Mineral Oils Company
ANGSPE	National Agency for Strategic Management of State Participation and Performance Monitoring of State-owned Enterprises (Morocco)
BOS	Businesses of the State
BSIC	Business Sector Information Center
CDSB	Climate Disclosure Standards Board
CEO	Chief Executive Officer
CPSD	Country Private Sector Diagnostic
EAS	Egyptian Accounting Standards
EBRD	European Bank for Reconstruction and Development
ERSAP	Economic Reform and Structural Adjustment Program
ESG	Environmental, Social and Governance
GDP	Gross Domestic Product
GIMC	Government Investment Management Company (Jordan)
GREs	Government-related Entities
GRI	Global Reporting Initiative
IAASB	International Auditing and Assurance Standards Board
ICT	Information and Communication Technologies
IFAC	International Federation of Accountants
IFI	International Financial Institution
IFRS	International Financial Recording Standard
IIRC	International Integrated Reporting Council
IMF	International Monetary Fund
ISA	International Standards on Auditing
iSOEF	Integrated State-Owned Enterprises Framework

ACRONYM	MEANING
KPI	Key Performance Indicator
LLC	Limited Liability Company
MENA	Middle East and Northern Africa
MOA	Military-owned Authorities
MOF	Military of Finance
MOT	Ministry of Transportation
MPBS	Ministry of Public Business Sector
NEPCO	National Electric Power Company
NIB	National Investment Bank
NSPO	National Service Projects Organization
OECD	Organisation of Economic Co-operation and Development
OIA	Oman Investment Authority
PBS	Public Business Sector
PFM	Public Financial Management
PPP	Public-Private Partnership
PSO	Public Service Obligation
RBC	Responsible Business Conduct
SASB	Sustainability Accounting Standards Board
SEPE	Executive Secretariat for Public Enterprises (Djibouti)
SME	Small and Medium Enterprises
SOB	State-Owned Bank
SOE	State-Owned Enterprise
SOHC	State-Owned Holding Company
SOP	State Ownership Policy
TCFD	Taskforce on Climate-related Financial Disclosure
WBG	World Bank Group

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I. EXECUTIVE SUMMARY AND RECOMMENDATIONS

This report is part of a World Bank review of state-owned enterprise (SOE) governance practices in the Middle East and North Africa (MENA) region. The focus on governance is motivated by research pointing to good governance as an important precondition for successful and sustainable SOE reform. This report summarizes findings of six SOE governance reviews of Djibouti, Egypt, Jordan, Morocco, Oman, and Tunisia, while also drawing on other regional studies.

The six country reports, as well as this cross-cutting report, concentrate on the core dimensions of corporate governance of SOEs as identified in the Organization for Economic Co-operation and Development (OECD) Guidelines for Corporate Governance of SOEs, and the World Bank's Integrated SOE Framework (iSOEF). These include: (i) the legal and regulatory framework for corporate governance; (ii) state ownership arrangements; (iii) performance management frameworks; (iv) Board structures and functioning; (v) financial reporting, accountability, control, and transparency; (vi) procurement policies and practices; and (vii) climate change reporting practices. The report also provides an overview of the "SOE landscape" in terms of the size, composition, employment, subsidies, and financial risks of the SOE sectors.

Several MENA countries have initiated significant SOE governance reforms. Over the last two decades, several MENA countries have improved their ownership practices by building stronger oversight bodies, holding boards more accountable, strengthening monitoring, tightening financial controls, corporatizing and, in some cases, privatizing SOEs. In Oman, almost all SOEs have been brought under the control of the Oman Investment Authority, which is in the midst of comprehensive and ambitious governance reforms across the entire portfolio. In Djibouti, the government has initiated many reforms to increase transparency and improve governance practices. In Egypt, the 2022 State Ownership Policy — the first in the region — demonstrate the country's commitment to a more efficient and transparent SOE sector, including the growing involvement of the private sector. In Jordan, the corporatization of all SOEs under the Company Law and the consolidation under the ownership of a holding company (Government Investment

Management Company, GIMC) provides a strong basis to undertake further governance reform. In Morocco, the establishment and operationalization of the SOE ownership agency, the National Agency for Strategic Management of State Participations and Performance Monitoring of State-owned Enterprises (ANGSPE), as well as amendments to the regulatory framework and the privatization regime, demonstrate the continued attention to optimizing the country's SOE portfolio.

However, these efforts often fall short of expectations due to a lack of political will, political economy issues, as well as pressures from a complex web of interests. Despite reforms, financial weaknesses, subsidies, overemployment, fiscal risks, and corruption persist. The absence of "know-how" has rarely been the primary impediment. Reform efforts are more likely to founder on political economy issues, opposition from entrenched interests, and a lack of strong political support. In some ways, this is understandable because decision-making regarding SOEs is highly politicized. They are used to generate employment, subsidize the population, and thereby win political support. Yet, at the same time, realizing that failures have real and significant repercussions, policy makers continue to look for solutions to make SOEs more accountable and competitive. What appears clear is that addressing political economy issues which have, heretofore, represented the major roadblock to reform, will be essential for any significant future progress. Any projects designed to reform SOE governance should, as a consequence, include a political economy component, as well as a plan for how political economy issues can either assist or impede reform.

The SOE landscape in the MENA region

Despite periods of privatization, public enterprises in the MENA region remain deeply woven into the fabric of society. Their success in economic terms, as well as in a broader social sense, can be seen as crucial to the ongoing development of the region. The rise of SOEs in MENA can largely be traced to the 1950s and 1960s, when governments viewed state ownership and economic planning as means to achieve social justice, economic equality, and development. The SOE sector continues to carry a relatively greater weight in MENA

than in the OECD area, and their number is growing. When including subsidiaries and firms in which SOEs have ownership, the degree of state ownership in some countries may be far greater than has been previously recognized. Consequently, the economic impact of SOEs may be greater than had been recognized, including the budgetary and fiscal risks to the state.

Debt and financial support to SOEs are often significant. Countries may provide explicit subsidies and transfers or inject equity to support, bail out, restructure, lower debt or resolve arrears. Thus, the multiplicity of ways in which SOEs may receive support makes it difficult to ascertain the full costs of state ownership. Public Service Obligations (PSOs) are common and often unfunded, which exacerbates the poor financial performance of many SOEs. The relative importance of SOEs in MENA and their role in delivering non-commercial services and benefits (such as employment) means that analyzing and understanding the political economy of further reforms will be critical to success.

Despite their different stages of development, there is considerable consistency across the six country case studies with respect to many challenges and the actions that need to be taken. The main findings and recommendations that emanate from the country reports follow.

Legal and regulatory frameworks for SOE governance

There is a broad need to address the improvement and implementation of legal and regulatory frameworks for SOE ownership. Ownership arrangements are generally fragmented with line ministries typically playing the main role in directing SOEs. It is also common for the ownership and regulatory responsibilities of the state to be combined. However, there are encouraging examples of the professionalization of ownership arrangements and evidence of greater centralization. Although circumstances vary from country to country, in general, it is common for the state and political actors to be involved in operational decision-making in the SOEs. Throughout the region, it is common for boards

to be composed of civil servants who are generally not well trained to run businesses. As such, they are unable to take independent decisions. Furthermore, they are obligated to implement instructions from political superiors.

Recommendations:

- ➔ Review and adapt legal frameworks for SOEs to good international practice standards.
- ➔ Adopt simple, clear, and uniform definitions of “SOEs” within the framework.
- ➔ Develop and disclose clear rationales and principles for state ownership in accord with international practice, and develop a policy to divest when appropriate.
- ➔ Clarify the roles of owners, boards, and management.
- ➔ Ensure the effective separation between the state’s role as owner, policy maker and regulator.
- ➔ Enforce corporate governance codes for SOEs, as well as strong governance disclosures.

State ownership arrangements

Explicit rationales that justify state ownership based on disclosed criteria are rare. Most MENA countries do not subject the state’s portfolio of SOEs to a regular evaluation or systematically consider the justifications for continued state ownership. Rationales for state ownership should be more broadly implemented throughout MENA in order to stem potentially uncontrolled expansion of the sector and reduce state ownership where it is not needed. Only very few countries in the MENA region have a clearly identifiable “ownership policy” that defines the objectives of the state as an owner, as well as the institutions and means by which the state achieves its objectives.

Recommendations:

- ➔ Establish a central ownership or coordinating agency for SOE oversight and SOE reform.
- ➔ Develop and publish an SOE ownership policy.
- ➔ Conduct monitoring and aggregate reporting on the SOE sector.

Performance management frameworks

The oversight of SOEs tends to be fragmented, and aggregate reporting is rare. It is common for a variety of independent institutions to monitor SOEs. However, there is often no single body able to provide a comprehensive or exhaustive view of the SOE sector. Aggregate reporting concerning the state's SOE portfolio from a shareholder perspective is largely absent. Thus, a core challenge in assessing SOE performance is to disentangle the multiple objectives of different state institutions and stakeholders in SOEs.

Recommendations:

- ➔ Define clear mandates for SOEs, including financial targets, capital structure objectives, capital allocation, and risk tolerance levels.
- ➔ Require SOEs to submit multi-year strategic plans to their respective boards.
- ➔ Promote the signing of performance contracts containing key performance indicators.
- ➔ Clearly define and create a funding framework for PSOs.

Board structures and functioning

Boards throughout the region can benefit from reform. Board member nomination processes are not generally formalized or transparent. As such, they do not necessarily yield the candidates best suited for board posts. The composition of boards in MENA tends to be skewed heavily toward high-level public sector profiles. Also, many boards do not fulfill the duties and roles generally expected of them in accordance with good practices. Another common problem is the limited autonomy afforded to boards. The independence of the SOE boards is recognized as an important goal, but it remains elusive.

Recommendations:

- ➔ Introduce a structured, merit-based process for reviewing nominations for board positions.
- ➔ Enhance board composition and functioning.
- ➔ Strengthen the role of board audit committees.

Financial reporting, accountability, control, and transparency

The quality of disclosure by SOEs is generally poor, and too many SOEs do not disclose anything apart from basic company information. The minimum standards of disclosure for larger SOEs should be equivalent to those of listed firms, including the use of International Financial Reporting Standards (IFRSs). The disclosure of the PSOs of the SOEs and their costs, which is considered a good practice, is generally not done. In addition, the audits of annual financial reports are not generally conducted using International Standards on Auditing (ISA), thereby making the annual financial reports of many SOEs unreliable. The frequent qualified opinions in the audit reports of many SOEs are a key concern. They suggest the need for a more proactive approach to addressing the accounting issues that give rise to these qualifications. Even though SOEs are subject to numerous controls, there is concern regarding the effectiveness of control systems. Multiple instances and layers of control in the public sector can obfuscate responsibility and reduce accountability. Throughout the MENA region, a review of the control environment of SOEs could help to improve their operational efficiency, reporting, accountability, and risk management.

Recommendations:

- ➔ Strengthen SOE transparency and disclosure.
- ➔ Consider the establishment of an independent oversight authority of statutory auditors.

Procurement policies and practices

National procurement rules in MENA generally apply to all SOEs. However, there is no formal consideration of the rationale for using public rules or distinctions based on whether SOEs compete with the private sector.

Recommendation:

- ➔ In some cases, governments would benefit from separate procurement regulations for SOEs.

SOE policies and practices related to climate change actions and reporting

Environmental, Social and Governance (ESG) is an emerging theme that has not yet been fully integrated into the operations of SOEs, or in the deliberations of SOE boards. Although ESG reporting is now commonplace in listed companies on the world's largest exchanges, SOEs in MENA rarely report on climate risks.

Recommendations:

- ➔ Establish rules for mandatory climate reporting (through corporate governance codes and/or listing rules) based on an internationally recognized climate reporting framework.
- ➔ Allow a transitional period of 2-3 years before requiring mandatory compliance.
- ➔ Encourage voluntary compliance during the phase-in period.
- ➔ Ensure independent oversight of the reporting requirements (for instance, through the financial auditing framework).

What's next?

A new regional framework for SOE reform? Most MENA countries are committed to SOE reform. However, despite years of efforts, there is still significant scope for improvement in terms of performance, governance frameworks, competitive neutrality, and financial risks. Thus, the World Bank is in the process of developing the MENA SOE Compact in support of continued SOE reform. The Compact proposes a new, regional approach to help national authorities identify, encourage, and monitor SOE reform, as well as to develop technical solutions based on the best international and regional practices. The Compact will allow countries throughout the region to share their experiences, understand what practices work best in MENA, and create support and momentum for reform. The Compact process will identify common challenges and assist participating countries in identifying needs, while also enabling the World Bank to respond quickly and effectively with technical and financial assistance as requested.



II. INTRODUCTION

This report is part of a World Bank review of state-owned enterprise (SOE) governance practices in the Middle East and North Africa (MENA) countries.

Responding to the scarcity of data concerning SOE governance practices in the MENA region, in late 2021, the World Bank initiated a project to review SOE governance practices in the region. The purpose of the project is to develop and disseminate knowledge about SOE governance in order to promote continued SOE reforms. The focus of the report is SOE governance; however, to reap the full dividends from a SOE reform program, governments need to embrace a comprehensive approach that examines the full set of policies that apply to the SOEs. This includes not only governance, but also fiscal reforms, competition policy, and environmental policy, as well as reforms of individual SOEs. Recognizing this, the World Bank has developed a broader reform program, the MENA SOE Compact, which brings together these various reform strands into the development of a comprehensive roadmap for reform. This project is expected to be formally launched in late 2023.

The high participation of the state in the economy in the MENA region has the potential to inhibit economic dynamism and growth. The SOEs are a key element of MENA's social contract and economic development strategy. Yet, the SOEs, combined with an uneven regulatory and policy environment, can: (i) limit private investment; (ii) direct capital toward low-productivity activities; and (iii) exacerbate the misallocation of resources, which ultimately slow growth and inhibit job creation.

This particular focus of this report is on governance. It is motivated by research pointing to good governance as an important precondition for successful and sustainable SOE reform. Recent studies by the World Bank, the International Monetary Fund (IMF) and the European Bank for Reconstruction and Development

(EBRD) highlight the predominance of corporate governance issues in explaining SOE performance.¹ SOE reforms in countries with relatively good governance and anti-corruption practices are significantly more successful than in other countries. Furthermore, in countries with good governance arrangements, the productivity gap between private firms and SOEs shrinks considerably. Given the limited appetite among most MENA governments for significant privatization of their SOE portfolios, SOE governance will remain a key lever of reform.

Better data about SOE practices can inform improvements in SOE governance and performance.

It is possible to draw general conclusions about SOE performance and challenges in MENA. However, the current governance structures and transparency and accountability practices are characterized by a scarcity of data and limited, structured information. As seen in other policy domains, country comparisons and illustrations of regional good practices may be able to spur peer-to-peer learning and help better inform policy options.

This report summarizes the findings of six governance reviews of SOEs in Djibouti, Egypt, Jordan, Morocco, Oman, and Tunisia. By taking stock of the findings from these six country studies, the intent is to inform ongoing policy dialogues, as well as to feed into the peer-based reform program envisioned by the MENA SOE Compact. It should be recognized that MENA is diverse in its economic structures, public sector administration, and SOE governance practices. Each country is distinct, and the descriptions in this note may not apply to all individual countries — even if they are generally representative of the region.

The methodological framework for the country reviews is based on the Organisation for Economic Co-operation and Development (OECD) Guidelines on the

¹ IMF, "Fiscal Monitor Report – April 2020, Chapter 3. (Washington, DC: IMF, 2020). World Bank Group, "State Your Business! An Evaluation of World Bank Group Support to the Reform of State-Owned Enterprises." (Washington, DC: World Bank Group, Independent Evaluation Group, 2020). EBRD, "Transition Report 2020-2021" (London: European Bank for Reconstruction and Development, 2020).

Corporate Governance of State-owned Enterprises (OECD Guidelines) and the World Bank’s Integrated SOE Framework (iSOEF). This note also draws on other reports concerning SOE ownership in MENA published by the IMF, the OECD, and the World Bank Group. This information is used to provide the reader with more general insights into SOE governance in the region.

In particular, the Note’s Landscape chapter draws on data and contributions from the World Bank’s Global Businesses of the State (BOS) database. The structure of this note follows that of the individual country reviews. As such, it seeks to capture and synthesize the major, high-level themes. A more extensive discussion of the methodological framework is included in Annex 1.



III. THE SOE LANDSCAPE

SOEs as a part of the societal fabric

Public enterprises in the MENA region remain deeply woven into the fabric of society. A strong statist legacy is visible throughout the region, which the OECD in 2013 referred to as a form of “state capitalism” in which government and the public and private sectors are deeply intertwined.² SOEs have traditionally been used as a motor for industrial development, the provision of key goods and services, the generation of employment and a variety of other objectives, some purely commercial and others social in nature. They have also been important contributors to social stability. An alternative perspective maintains that SOEs have also been a source of corruption, mismanagement, and stagnation, thus posing significant burdens on state budgets. Nonetheless, their success, not only in economic terms but also in a broader social sense, can be seen as crucial for the ongoing development of the MENA region.

The development of a large SOE sector in many MENA countries can be traced to the 1950s and 1960s.

Some of the key determinants were: (i) a desire for state building in the large number of MENA countries that achieved independence during that time; (ii) the concomitant rise of Arab socialism during a time when governments viewed state ownership and economic planning as a means to achieving social justice, economic equality, and development; (iii) a desire to control the exploitation of natural resources, particularly oil and gas, that were developed in the middle of the 20th century; and (iv) the use of SOEs to pursue national and strategic objectives using the new-found wealth generated by oil and gas development. The result was that many countries went from having very few SOEs in the 1950s to having an economy dominated by SOEs in the 1970s. Despite periodic efforts to divest or privatize

SOEs, they continue to play an outsized role in most MENA countries.

What constitutes a SOE is not uniformly agreed across jurisdictions in MENA; in fact, within jurisdictions, different definitions can be used in various contexts.

Harmonization of what constitutes a SOE, at least internally, is a relatively easy step. In fact, harmonization facilitates policy consistency. For the purposes of this report, the definition used is the one adopted by the OECD: “A SOE is a commercial enterprise that is more than 50% owned or controlled by a government.” However, it should be noted that the World Bank’s Business of the State data cited later in this report is based on a more expansive definition: “The ownership threshold used to determine whether an enterprise is a “business of the state” is set at 10% ownership by a majority state-owned entity.” This means that that data potentially shows a far more extensive SOE sector than would be measured using the OECD definition.

Defining and identifying the number of SOEs

The SOE sector carries relatively greater weight in MENA than in the OECD area.³ According to OECD and IMF calculations, the average number of SOEs in an OECD country is approximately 50. Although comparable statistics are hard to come by, most countries in MENA will easily exceed this figure — and even more so when SOEs are counted on a per capita basis.⁴ According to official reports, Djibouti had 84 SOEs in 2020; Egypt had 381; Morocco had 269 public enterprise and 44 Limited Liability Companies (LLCs); Oman had 170 entities; and Tunisia had 110 entities. Jordan is the outlier, with only 18 fully or majority owned SOEs. However, SOEs are still dominant in Jordan; according to an IMF report, the total unconsolidated assets of SOEs represented around 20 percent of gross

² OECD. “State-Owned Enterprises in the Middle East and North Africa: Engines of Development and Competitiveness?” (Paris: OECD Publishing, 2013). <http://dx.doi.org/10.1787/9789264202979-en>

³ Caution is advised when making comparisons because countries include entities in their definition of a SOE that would not necessarily follow the widely accepted definitions of the OECD or the IMF. For example, in Morocco, there are a variety of government-related entities including “state enterprises”, “public subsidiaries”, and “mixed corporations”. In Djibouti, 38 of the 84 government-related entities are in the health and social welfare sector. These entities would likely not be considered SOEs using the OECD definition.

⁴ World Bank. “Middle East and North Africa, Governance Reforms of State-Owned Enterprises (SOEs), Lessons from four case studies (Egypt, Iraq, Morocco and Tunisia).” (Washington, DC: World Bank, 2015).

domestic product (GDP) in Jordan as of 2019.⁵ In each case, the number of SOEs should be considered with caution because many countries do not maintain comprehensive databases. In addition, there is often no official definition of what an SOE is. In Egypt, for example, the Ministry of Finance reports a total of 381 SOEs.⁶ However, many military SOEs and other civilian enterprises are not included.⁷ Using a definition consistent with the OECD's SOE definition that includes a criterion of control (irrespective of percentage ownership), the SOE Governance Review of Egypt identifies 442 entities operating under different legal forms.

It is noteworthy that, despite years of privatization and efforts to streamline the public sector, the number of SOEs in some MENA countries is growing. This growth is significant because it contrasts with a fairly constant number of SOEs globally.⁸ Countries have the prerogative to establish new SOEs to meet their legitimate objectives. However, good practice suggests that the establishment of new SOEs should be subject

to a "rationale for state ownership".⁹ Alongside a clear rationale for ownership, there should be a sound governance framework for oversight. Among the countries reviewed, Djibouti went from eight SOEs at the time of its independence in 1977 to 84 at the time of this writing. It added 26 enterprises in the port sector alone in the last 10 years. In Egypt, enterprises owned by the military play a significant role in many sectors, including manufacturing, agriculture, and construction—and their role is expanding. Although NSPO was established in 1979, a third of its 32 affiliated companies were established after 2015, suggesting an expansion of NSPO economic activity in recent years, spread across 14 industry groups.¹⁰ Morocco exhibited strong growth in the past 10 years, and Tunisia added six public enterprises to the state portfolio between 2017 and 2020. Some progress was made in restructuring and privatization in the 1990s. However, SOEs continue to expand across sectors and different regulatory frameworks. In both Jordan and Morocco, there have been privatization efforts through the 1990s and 2000s,

⁵ IMF (2021).

⁶ As a requirement of a 2016 IMF program, the Ministry of Finance prepared and disclosed on its website reports concerning Egypt's SOE portfolio. They comprise: (a) an overview of specific business sectors; (b) a list of enterprises in each sector and type of ownership (for example, wholly or majority-owned); and (c) information concerning individual companies, including summarized standalone balance sheets and income statements, board composition, and external auditors. These reports include different categories of SOEs based on what entity directly owns the majority of share capital as follows: (1) First level or Primary SOEs: directly owned by the state treasury. Enterprises such as National Bank of Egypt (Egypt's largest commercial bank) and Arab Contractors (one of the largest construction companies) fall under this category, as well as most of the Law 203 holding companies. (2) Second level SOEs: entities owned by first level entities. This category includes the Law 203 subsidiary companies, as well as enterprises owned by Economic Authorities. (3) Third level: Joint enterprises, majority owned by a second-level entity. An example of this category is the Alexandria Mineral Oils Company (AMOC). The majority of AMOC shares (listed on the Egyptian Stock Exchange) are owned by Alexandria Oil (a wholly owned subsidiary of an Economic Authority controlled by Ministry of Petroleum).

⁷ For example, this would include the subsidiaries of the National Service Projects Organization (NSPO) and the Arab Organization for Industrialization (AOI). The National Authority of Military Production (an organization that is very similar to an Economic Authority) owns several enterprises that are not included in the portfolio reports of the Ministry of Finance. Also excluded from the reports are other large SOEs, such as the new administrative capital company, which is also controlled by the military. No financial information is currently publicly available about these organizations or subsidiaries. Furthermore, other civilian enterprises, such as the National Investment Bank and its subsidiaries as well as some enterprises controlled by the Ministry of Finance, are not included in the Ministry's portfolio report.

⁸ OECD. "The Size and Sectoral Distribution of State-Owned Enterprises." (Paris: OECD Publishing, 2017). <http://dx.doi.org/10.1787/9789264280663-en>

⁹ Rationales for state ownership are described in detail in the OECD Guidelines (2105), Chapter I. They provide guidance about when the state should be involved in the ownership of productive assets and when it should divest itself of such assets. Summarized, the rationales for establishing or maintaining state enterprise ownership typically include one or more of the following: (1) the delivery of public goods or services where state ownership is deemed more efficient or reliable than contracting out to private operators; (2) the operation of natural monopolies where market regulation is deemed infeasible or inefficient; and (3) support for broader economic and strategic goals in the national interest, such as maintaining certain sectors under national ownership, or shoring up failing companies of systemic importance.

¹⁰ International Finance Corporation. "Creating Markets in Egypt. Realizing the full potential of a productive private sector." (Washington, DC: 2020)

which have limited the number of SOEs, if not their importance to the economy. Similarly in Oman, there is currently an active program of divesting shares in SOEs, although often this is for non-controlling stakes. Thus, it will not actively reduce the number of SOEs.

The reported number of SOEs includes entities that operate under a variety of different legal forms, meaning that they may not be entirely comparable.

The countries covered in this report apply a variety of different concepts and definitions to discuss what can be termed, more broadly, government-related entities. These entities can, depending upon the country, be part of the public administration, municipal enterprises, or provide public services such as hospitals. They can have different legal forms including statutory enterprises, corporatized entities, or autonomous entities within the public administration. Even within a single country, the categorization can be made difficult by definitions that are unclear or applied inconsistently. A 2015 report by the World Bank notes that “The term SOE refers to neither a unified legal regime nor a uniform reality”.¹¹ This lack of clarity makes it difficult to define the appropriate benchmarks for good practice and to develop targeted recommendations. If there is no common definition of SOE, it can create challenges in terms of establishing and maintaining an overview of the “SOE portfolio”, and subsequently in designating different strategic priorities to different kinds of public enterprises. The OECD adheres to a relatively strict definition of a SOE. It defines SOEs as basically corporatized commercial enterprises that are controlled (either through ownership or other means) by the state. This definition enjoys wide consensus among most experts and across countries. Thus, at a regional level,

it would be useful to gather aggregate data about the number, type and size of SOEs in the MENA region based on this consistent definition.

Employment in SOEs

The level of employment generated by SOEs varies, although some estimates suggest that SOEs provide less than 4 percent of total employment in MENA.¹²

This is broadly in line with OECD countries. It also reflects the fact that many SOEs are infrastructure based, with high levels of economic importance despite relatively low levels of employment.¹³ The MENA SOEs are frequently overstaffed because they have been used to stabilize and grow employment, as well as a means to reward political support. Though the statistics are dated and do not correspond directly to SOEs, the IMF estimated that the MENA region had the highest central government wage bill in the world. It is close to 10 percent of GDP, as opposed to just over 5 percent globally.¹⁴ In Egypt, so-called Economic Authorities represent 6 percent of public sector employment, and incorporated SOEs employ an additional 12 percent as of 2022.¹⁵ According to the Morocco SOE Governance Review, SOE employment represents 4 percent of total employment. In Jordan, SOE employment represents less than 1 percent of total employment.¹⁶ Excess employment is one of the key factors that weighs on SOE performance throughout MENA. It is also one of the most politically sensitive issues to address. Reliable and comparable data concerning employment and the employment impact of SOEs is often difficult to find in MENA. Consequently, it would be beneficial for countries to consider improving their data sources.

¹¹ World Bank. “Middle East and North Africa, Governance Reforms of State-Owned Enterprises (SOEs), Lessons from four case studies (Egypt, Iraq, Morocco and Tunisia).” (Washington, DC: 2015).

¹² IMF. “State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges.” DP/2021/019 (Washington, DC: IMF, 2021).

¹³ OECD. *The Size and Sectoral Distribution of State-Owned Enterprises*. Paris: OECD Publishing, 2017), p 25. <http://dx.doi.org/10.1787/9789264280663-en>

¹⁴ IMF. “State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges.” DP/2021/019 (Washington, DC: IMF, 2021).

¹⁵ CAPMAS, Annual Bulletin of Employees Statistics in Public/Public Business Sector 2022 - March Edition; and Ministry of Finance press release, October 2022.

¹⁶ IMF. “State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges.”, DP/2021/019 (Washington, DC: IMF, 2021).

SOEs as a percentage of GDP

The contribution of SOEs to GDP varies considerably, as does SOE debt and the amount of state transfers to SOEs. Current data collection methods do not always allow for a valid comparison of SOE macro data across countries since methodologies and methods vary considerably. However, the overall picture shows a significant participation of government-related entities in economies throughout the region. In Egypt, Economic Authorities and SOEs had assets representing 135 percent of GDP at the end of June 2019 (according to the Ministry of Finance [MOF] data). In Morocco, the portfolio of public enterprises was reported to have annual revenues equivalent to 22 percent of GDP. In Jordan, the total unconsolidated assets of SOEs represented around 20 percent of GDP as of 2019.¹⁷ In Tunisia, as of 2014, SOEs accounted for 9.5 percent of GDP and 15.7% of fixed capital at the national level.¹⁸ SOE debt is equal to more than $\frac{1}{3}$ of GDP.¹⁹ In some cases, individual enterprises or industries can represent a significant percentage of GDP, thereby presenting significant potential risks for the state. In Oman, the IMF in its 2022 country report²⁰ noted that as of end-2021, Oman's economy remains dependent on the state-controlled hydrocarbon industry, representing about 35 percent of GDP, 75 percent of total fiscal revenues, and 58 percent of the total exports of goods. Djibouti Telecom's total revenues have been reported to represent almost 7 percent of the country's GDP.²¹

Profitability and financial sustainability

MENA SOEs have suffered from the challenges commonly associated with state ownership. These include poor financial performance which, in turn, leads to strained state budgets and contingent risks. SOEs are often associated with: (i) bloated and bureaucratic human resources; (ii) inadequate services and products for the consumer; (iii) poor maintenance; (iv) a lack of public transparency and accountability; and (v) vulnerability to mismanagement, nepotism, conflicts of interest and corruption. These problems are not unique to MENA. Indeed, they are seen, to varying degrees, in many jurisdictions. However, the MENA region as a whole lags in terms of good practice in implementing the policies and procedures that can be used to attenuate the problems typically associated with state ownership.

In aggregate terms, many SOEs in MENA are reporting losses that weigh heavily on state budgets.

In Morocco, profits fell considerably in 2020 due to the pandemic, with strategic SOEs registering a decline in operating income and net profits of 82 percent and 194 percent, respectively. IMF data covering Tunisia's 30 largest SOEs shows that two-thirds were loss-making in 2019, with rapidly declining capital. Half were considered insolvent.²² Moreover, three of the largest SOEs in Tunisia had negative equity equivalent to almost 5 percent of GDP.²³ The same report

¹⁷ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019 (Washington, DC: IMF, 2021).

¹⁸ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington, DC: IMF, 2021), p. 17.

¹⁹ Ministère de l'économie, des finances et de l'appui à l'investissement Ministry of Finance. "Rapport sur Les entreprises publiques." 2023.

²⁰ IMF. "Oman Staff Report for the 2022 Article IV Consultation." (Washington, DC: IMF, 2022), Accessed from Imf.org on 14 February 2023.

²¹ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (citing WB 2018). (Washington, DC: IMF, 2021), p. 11.

²² IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington, DC: IMF, 2021), p. 13.

²³ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington, DC: IMF, 2021).

suggests that 107 SOEs in Egypt reported losses for the fiscal year ending 2019. The IMF cites the example of four MENA countries (Egypt, Iraq, Morocco, and Tunisia) with SOEs having amassed sizeable annual losses, with the share of total losses ranging between 0.6 percent and 6 percent of GDP annually.²⁴ Losses at single large companies can also have an outsized effect. For example, according to a published report by the Jordan Audit Bureau and the annual statements of the largest Jordanian SOE, the National Electric Power Company, had accumulated total commercial debt of Jordanian Dinar (JOD) 3.12 billion (approximately US\$ 4.4 billion), representing around 9.6 percent of GDP as of end-2022. According to NEPCO's annual report, its debt surpasses the limit of 75 percent of paid-in capital, which would necessitate the liquidation of the subject firm under the Jordanian companies' law,²⁵ unless the general assembly decides in an extraordinary meeting to increase the Company's capital. Several factors play a role in NEPCO's current financial situation, including the sector structure, exogenous shocks, energy policy decisions (which are made outside of NEPCO), tariff setting policies, and the need for enhanced corporate governance models, among others. It should be noted that NEPCO is currently implementing a corporate governance action plan. In addition, the Government of Jordan's Energy Program has set up clear commitments towards improved corporate governance within NEPCO.

A significant challenge for SOEs is achieving fair compensation for the public service obligations (PSOs) that they are expected to deliver. This is a common problem for SOEs in many jurisdictions. A core challenge in assessing SOE performance is to disentangle commercial and non-commercial objectives. Properly identifying, costing and funding

PSOs allows for non-commercial objectives to be integrated into the SOEs' profit-making objective. It also helps with SOE management, while supporting better fiscal management as the true cost of policies cannot be hidden in the SOE balance sheets. Often the disbursement of funding is dependent on the health of the state's coffers. As such, it may or may not be forthcoming, depending upon the political exigencies of the moment. The absence of full and fair compensation for the costs of PSOs is one of the central causes of the poor performance of many SOEs, particularly public utilities whose pricing is politically sensitive. Even where proper or full funding is not provided, this should not prevent proper identification and costing of PSOs. At the least, this can allow for more transparent acknowledgement of the true fiscal risks and costs of the PSOs, as well as the detrimental impact on SOE profitability.

A new view regarding the weight of SOEs in MENA economies

Data from the World Bank's Equitable Growth, Finance and Institutions (EFI) Global Businesses of the State (BOS) database suggests that the degree of state ownership of enterprises in the economy of some MENA countries may be greater than has been recognized in the past.²⁶ The BOS is a World Bank Group initiative to develop a global database of SOEs. For the MENA region, it currently includes information about Egypt, Jordan, Lebanon, Morocco, and Tunisia, with additional economies being added.²⁷ The BOS provides insights into the degree of state ownership. It also raises questions regarding whether pervasive state ownership is in a country's economic and social interests. In total, 1,962 firms with state participation in commercial activities have been initially identified

²⁴ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington, DC: IMF, 2021), p. 8.

²⁵ NEPCO (2020) and Audit Bureau (2021).

²⁶ The information from the BOS presented in this report is preliminary and subject to change. All values are generally for 2019. However, when information was not available for 2019 in terms of sector of operation, revenues, employment, or profits, the database employs data reported as of 2018 or 2017 as the best proxy. The financial information was deflated to report prices as of 2019 using the World Bank Group GDP deflators.

²⁷ Data for Djibouti and Oman are in progress, and are thus not included in the following graphics.

(subject to validation from governments) in the four countries which are covered by the BOS as well as in this report – including 1,045 SOEs in Egypt, 229 in Jordan, 372 in Morocco, and 286 in Tunisia. These figures portray a higher figure for state ownership than other studies conducted at the time of this writing. The reason is, in part, because the ownership threshold used to determine whether an enterprise is a “business of the state” is set at 10 percent ownership by a majority state-owned entity.²⁸

The economic impact of SOEs may be far greater than had been recognized in the past, as may be the budgetary and fiscal risks to the state. Based on the information available, as a proportion of GDP (figure 1), the revenues of firms with state participation account for almost half of GDP in Egypt (47 percent), 39 percent in Jordan, 14 percent in Morocco, and around a third in Tunisia (35 percent).²⁹ Over 50 percent of firms in Tunisia, for which profit/loss data are available, are loss-making, along with 30 percent in Egypt and Jordan and 20 percent in Morocco. In 2019 alone, the losses of the 30 loss-making firms with state participation in Tunisia amounted to 2 percent of GDP. Although the Tunisian state has tried to improve the productivity and efficiency of the five firms by setting performance targets (in

the cereals, aviation, electricity, and gas sectors), the costs incurred by Tunisian firms with state participation continue to escalate.

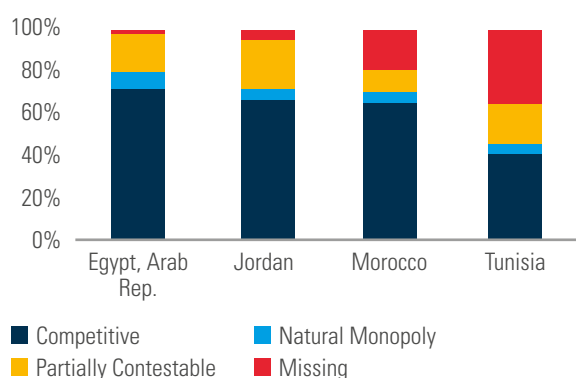
Competition with the private sector and questionable rationales for state ownership

The vast majority of SOEs among the surveyed countries are active in competitive sectors. More than 65 percent of the SOEs in MENA operate fully in sectors that could be served by the private sector (for example, the manufacturing of textiles). At the country level, 66 percent of SOEs are in competitive sectors in Morocco, 72 percent in Egypt, 67 percent in Jordan, and 41 percent in Tunisia (figure 1). The SOEs in the competitive sectors can also account for more than half of SOE revenues in two MENA countries including: Egypt (61 percent) and Morocco (51 percent). In other MENA countries, the revenue share of the competitive sectors is smaller, for example, with around 28 percent in Tunisia (figure 2). Furthermore, compared to OECD countries, the state is present in a wider variety of sectors in MENA. For example, the World Bank Group (WBG)-OECD Product Market Regulation data shows that an average MENA state is present in 18 commercial sectors compared to nine in the OECD.



²⁸ The 10 percent threshold was chosen by the BOS initiators based on the rationale that control cannot be measured *ex ante*. Also, even with minor participation, the state can outvote other shareholders (as in the case of holding the plurality of shares or possibly golden shares). However, the state can exercise disproportionate influence through informal interactions with the firm. Differences in the levels of state ownership compared to countries outside of the MENA region may not be as pronounced if the 10 percent were applied more widely in statistical studies. Thus, the ultimate threshold for being considered an SOE according to the OECD and other definitions is not based on percentage ownership, but rather on control which can be exercised with a plurality of shares. A common methodological approach would yield more comparable data. The advantage of the BOS database is that it reveals the full extent of the state’s footprint in the economy, including subsidiary entities of centrally held SOEs. Therefore, it provides a more complete assessment of fiscal implications and state participation in markets.

²⁹ Source: World Bank Global BOS database. It should be noted, however, that this figure may be higher, given that unconsolidated revenue data for the SOEs captured in the database is incomplete (48 percent of SOEs captured for Egypt have revenues data; 55 percent for Jordan; 39 percent for Morocco; and 26 percent for Tunisia).

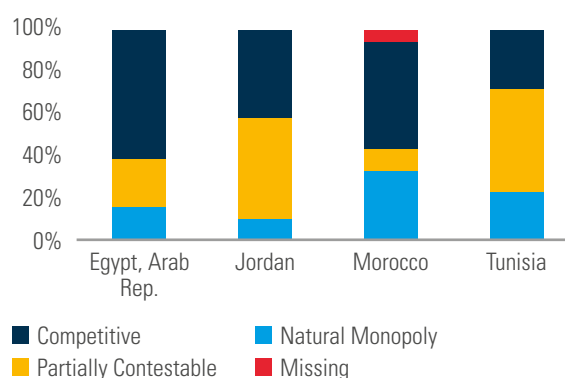
Figure 1: Number of Domestic SOEs by Sector Type

Source: The World Bank Global BOS database.

Note: Sector classification is available for 98 percent of BOSs identified in Egypt, 96 percent in Jordan, 82 percent in Morocco, and 65 percent in Tunisia.

Subsidiaries and indirect ownership of enterprises

Many SOEs have subsidiaries whose governance practices and ownership structures limit public accountability. Studies of SOE governance and performance tend to focus on the performance and governance practices of parent SOEs and larger SOEs controlled at the central level of the state. Far less attention has been spent studying the governance and performance of SOE subsidiaries. Subsidiaries are highly diverse in purpose, with some being operating units of a larger enterprise and others completely distinct and sometimes unrelated entities. Consequently, no one governance practice fits all. Common challenges in subsidiary governance relate to whether the parent entity can properly exercise the level of control appropriate to the nature of the business. Another challenge is excessive governance arrangements, which can add inefficiencies and pointless structures. In addition, countries may experience problems when the creation of subsidiaries is at the discretion of the parent, which may in turn lead to uncontrolled growth of the SOE sector. Many MENA SOEs have numerous subsidiaries that merit further study. Depending on the quality of monitoring arrangements, indirect ownership structures can hinder monitoring and transparency, the effective management of businesses, the exercise of ownership rights, as well as the capacity to conduct SOE reform.

Figure 2: Domestic SOEs: Unconsolidated Revenues by Sector

Source: The World Bank Global BOS database.

Note: Revenue data is available for 48 percent of SOEs identified in Egypt, 49 percent in Morocco (almost 20 percent of these are consolidated values), and 26 percent in Tunisia (11 percent consolidated).

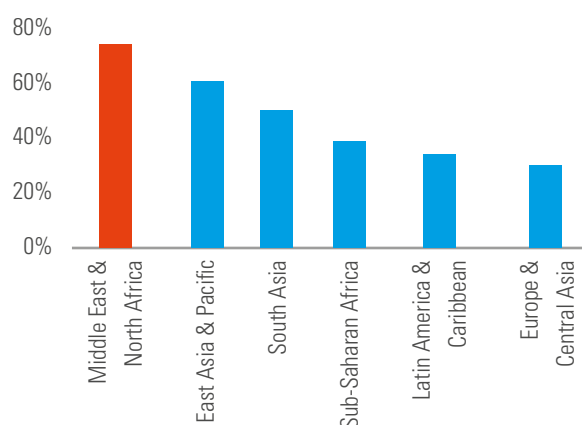
Indirect holdings and large conglomerate groups are common in MENA, with around 74 percent of SOEs in MENA being indirectly owned by the government through subsidiaries (figure 3). By comparison, that is more than double the proportion of indirect ownership in Europe and Central Asia (30 percent) and in Latin America (34 percent). In Egypt and Jordan, that figure reaches at or over 80 percent, whereas in Morocco and Tunisia it is around 40 percent (figure 4). In Oman, most of the 170 SOEs have been placed as subsidiaries to an industry level holding company, with those holding companies then also owned by the central holding company, namely, the Oman Investment Authority. This can lead to long chains of agents, with concomitant costs in both governance and competition. To illustrate, in Morocco, the Cash Deposit and Management (*Caisse de Depot et Gestion*) alone has more than 127 subsidiaries operating across multiple sectors. Indeed, it operates beyond the financial sector to include telecommunications, hotels, and forestry companies. Such links can also connect entire value chains. In Egypt, for instance, the Cotton Holding Group is related to more than 40 upstream and downstream companies, controlling fiber and yarn inputs, as well as apparel manufacturing. Although such integration may be justified based on competitive factors, it may limit the access of private enterprise to certain sectors – and increase the risk of anticompetitive practices. For example, an SOE in apparel manufacturing may benefit from lower input prices than private competitors.

Despite the large number of SOEs that are indirectly held by the state through subsidiaries of direct holdings, the vast majority of SOEs in Egypt, Morocco and Tunisia have government stakes of over 50 percent (figure 5).

State ownership in the MENA region may take place according to several different legal structures. In this context, such structures could benefit from rationalization. Although it is not uncommon for SOEs to be established as statutory enterprises (established by their own law) or as parts of the state administration, it is generally recommended that SOEs have a standard legal form (such as a joint-stock or limited liability company).

Such a company would operate under company law so that its governance and treatment under the law is effectively identical to that of a private sector enterprise. To illustrate the problem, in Djibouti, virtually all SOEs are established by their own individual law, thus requiring legislative action for each individual SOE to achieve sector-wide reform. This appears to be a complicated and time-consuming process. However, standardized legal forms greatly facilitate any potential reforms. The BOS database shows that, on average in the MENA region, only 50 percent of SOEs are corporatized, although it should be noted that in Jordan corporatization is almost universal (as it is in Oman) (figure 6).

Figure 3: Indirect SOEs by Region (%)



Source: The World Bank Global BOS database.

Note: The overall data coverage for government shareholding amounts is 100 percent in Egypt; 97 percent in Jordan; 100 percent in Morocco; and 92 percent in Tunisia. These numbers only include SOEs for which shareholding data is available.

Figure 4: Direct vs. Indirect Ownership of SOEs

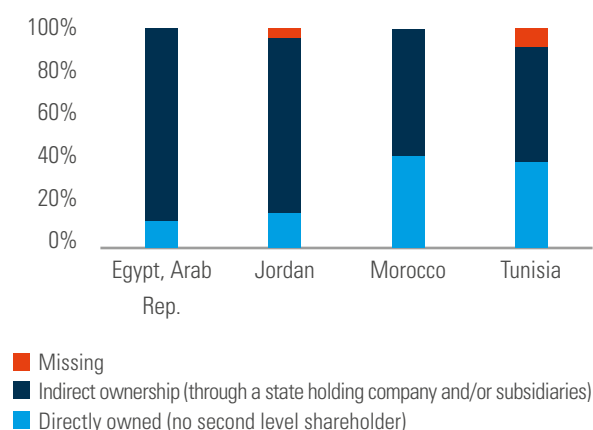
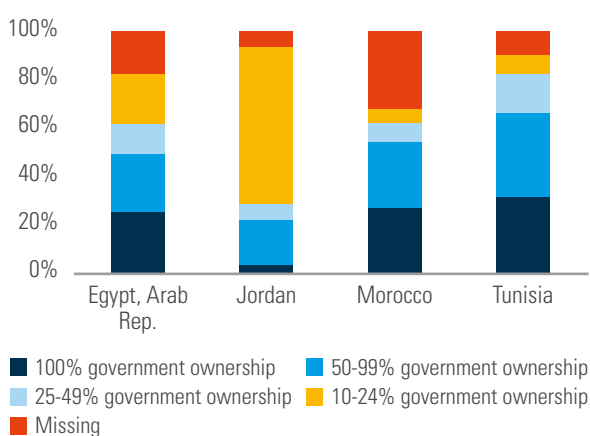


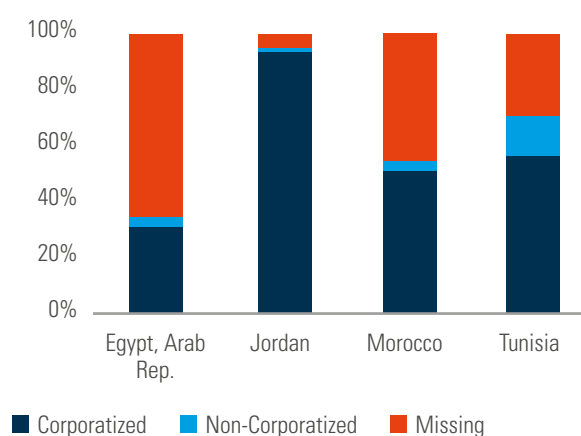
Figure 5: SOE Shareholding in MENA (%)



Source: The World Bank Global BOS database.

Note: The overall data coverage for government shareholding amounts is 100 percent in Egypt; 97 percent in Jordan; 100 percent in Morocco; and 92 percent in Tunisia. These numbers only include SOEs for which shareholding data is available.

Figure 6: Corporatized vs. Uncorporatized SOEs in MENA



Source: The World Bank Global BOS database.

Note: Data concerning legal form is available for 35 percent of all BOSs identified in Egypt; 95 percent in Jordan; 55 percent in Morocco; and 70 percent of SOEs identified in Tunisia.

Debt and financial support

SOE indebtedness varies across countries. In Morocco, the portfolio of strategic SOEs appears significantly, but not unreasonably, leveraged compared with private sector and sectoral benchmarks. However, according to a February 2021 IMF Article IV report, the debt of Tunisia's 30 largest SOEs was about 40 percent of GDP in 2019, with 20 percent of GDP due to banks and suppliers, and the rest to social security funds, other SOEs and the government. The Tunisian Ministry of Finance SOE Report (2022) indicated that, in 2020, the public debt of 50 SOEs (out of 111) to state banks represented 59.2 percent of total debt due to banks. Similarly in Oman, the 2022 IMF Article IV Report found that SOE debt stood at 41.8 percent of GDP in 2021, although risks are mitigated by considerable assets held by the Oman Investment Authority. In Egypt, many Economic Authorities and corporatized SOEs are highly indebted, while also benefiting from sovereign guarantees.³⁰ Partial data covering Tunisia's 30 largest SOEs shows that their total debt was in excess of 20 percent of GDP in 2019.³¹ The above-mentioned IMF Tunisia country report suggests that the total debt of the 50 major SOEs represented more than 38 percent of GDP in 2020. Furthermore, SOEs owed more than 5.5 percent of GDP in arrears to the state in 2020, whereas the state owed about 7.9 percent of GDP to SOEs. Cross arrears between SOEs were estimated at about 2.5 percent of GDP.³² In some cases, the debts of SOEs are explicitly guaranteed by the state, whereas in other cases there are implicit guarantees. In either case, SOE debts can be the source of significant fiscal risks.

MENA states provide financial support to SOEs through a variety of means. Countries may provide

explicit subsidies and transfers, or they may inject equity to support, bail out, restructure, lower debt and/or resolve arrears of SOEs. They may also provide direct loans and "on-lending" (whereby the state borrows and then lends to the SOEs). In addition, the SOEs may benefit from inputs provided by other SOEs at below market prices. Such support can represent a significant portion of state budgets. In Djibouti, the state found it necessary to reduce subsidies because of the financial burdens they imposed on the state. In Egypt, state subsidies to SOEs represent approximately 1.3 percent of GDP.³³ Such subsidies do not include implicit subsidies through a reduced cost of capital, reduced dividends, implicit guarantees, or periodic bail outs. In Jordan, the subsidization of electricity and water tariffs has resulted in significant losses accruing to the electricity and water SOEs, thus creating significant fiscal risks. In Morocco, fiscal risk is increasing due to budget transfers to non-commercial SOEs. In Tunisia, direct fiscal support exceeded 7 percent of GDP in 2019 to compensate SOEs for below-market pricing.³⁴ However, a limited number of SOEs are sources of government revenues, in particular in energy-exporting countries where they can contribute up to 20 percent of general government revenues.³⁵ In Morocco, strategic SOEs receive comparatively little in the way of government transfers, and some profitable SOEs make regular dividend payments to government. Nevertheless, state support to SOEs appears to reduce the fiscal space for other priority spending. The multiplicity of ways in which SOEs may receive support makes it difficult to ascertain the full costs of state ownership. Overall, then, MENA countries would benefit from enhanced data concerning the variety of state support provided to SOEs in order to better understand and manage their associated impacts.

³⁰ According to the published fiscal year (FY) 2023 fiscal statement by the MOF, outstanding sovereign guarantees to EAs and SOEs reached Egyptian Pound (EGP) 1.66 trillion in January 2022, representing 21 percent of GDP. This was mainly concentrated in the petroleum, electricity, and housing sectors.

³¹ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington DC: IMF, 2021), p. 13.

³² IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington, DC: IMF, 2021), p. 29.

³³ Government of Egypt's FY2022/23 budget.

³⁴ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington, DC: IMF, 2021), p. 24.

³⁵ IMF. "State-Owned Enterprises in Middle East, North Africa, and Central Asia Size, Role, Performance, and Challenges." DP/2021/019. (Washington, DC: IMF, 2021), p 24.



IV. THE LEGAL AND REGULATORY FRAMEWORK FOR CORPORATE GOVERNANCE OF SOEs

The legal and regulatory framework

A strong legal and regulatory framework sets the foundation for the effective governance of SOEs.

The OECD Guidelines for SOEs recommend that legal and regulatory frameworks be designed to ensure a level playing field for all market participants, regardless of their ownership. This includes creating transparent, non-discriminatory, and market-oriented policies that encourage fair competition and efficient resource allocation. Where possible, SOE legal forms should be streamlined and aligned to the private sector. The guidelines emphasize the importance of clearly defining the role and objectives of SOEs, implementing strong corporate governance practices, and avoiding interference from the state in day-to-day operations. Additionally, they call for robust accountability and disclosure mechanisms to foster transparency, and for SOEs to be subject to the same laws, regulations, and oversight as their private sector counterparts.

There are some distinct elements to the policy challenges facing governments in the MENA region when it comes to establishing strong legal and regulatory frameworks for SOEs.

The first deals with how SOEs are organized as companies; a second with how governance rules are applied to SOEs and enforced; and a third with how to ensure that there is a competitive neutrality between SOEs and the private sector. This latter challenge requires consistent policy across a range of factors including, for instance, procurement, the funding of public service obligations, and SOE employment practices. However, for the present discussion, the important elements are the mechanisms that ensure that policy and regulatory functions are separated from ownership functions within the state and, as a corollary, that SOEs are subject to the same laws as those that applied to the private sector.

Legal forms of government-related entities

There is a need to define and streamline the legal forms of SOEs. The OECD recommends that SOEs be constituted under standard legal forms under company law, such as limited-liability or public limited companies. The two main reasons for this are that: (i) it permits

the implementation of SOE reforms on a sector-wide basis and does not necessitate the changing of myriad laws for each individual statutory enterprises; and (ii) the uses of standard legal forms makes it easier to ensure that the laws and governance requirements relating to companies apply equally to both private and public entities. In all of the countries reviewed, the term SOE (or similar) is not defined by law in a unified manner. Also, SOEs are regulated by numerous legal instruments. Even where SOEs are established under the relevant company law, they can be subject to both private sector rules (for example, listing rules) and public sector laws, for instance, those relating to employment, budgeting, investment, and procurement.

In MENA, there is a broad cross-section of approaches regarding how SOEs are established.

In Oman and Jordan, for instance, all entities are established under the applicable company laws. However, in both cases, there are a variety of legal forms available under the company law (for example, in Oman this ranges from public joint stock companies, private joint stock companies to a simpler limited liability company form). Each form has its own unique governance and disclosure requirements. For reasons that are not entirely clear, SOEs in both Jordan and Oman are established using these disparate forms rather than a single unifying structure. The OECD recommends that SOEs adopt the same level of governance and disclosure practices as publicly listed companies. Thus, it would make sense that all SOEs be ultimately established as public joint stock companies.

In Egypt, the current legal framework defines six categories of government-related entities.

Furthermore, the delineation between entities is often blurry, and the governance of an entity may not fully correspond to its legal form. Statutory SOEs tend to borrow features from both the private and public sectors. However, even corporatized entities may be subject to exceptions from company law, such as protection from insolvency. In Morocco, commercial SOEs that fall under the supervision of the new state ownership agency, the ANGSPÉ will, in the future, be transformed into limited liability companies. It is expected that their new legal status will provide greater flexibility to manage human and financial resources,

improve autonomy and accountability, and encourage better disclosure and governance standards. Therefore, SOEs will no longer be subject to legal restrictions to restructure their workforce, set competitive wages, or subject their staff regulations to state approval. In addition, the SOEs should also be able to raise debt more easily. Overall, standard legal forms promise to provide SOEs with greater agility and the capacity to react to challenging market conditions, as well as to better compete with the private sector.

Governance Codes

Although most jurisdictions have governance codes that apply to SOEs, compliance is generally poor. One country demonstrating progress on this issue is Oman, which (via the Oman Investment Authority, OIA) has recently issued a corporate governance code for SOEs. Although there are some gaps in compliance, the OIA is now tracking adherence to the code as part of its performance management framework for SOEs. In Jordan, there are different codes for listed companies (issued by the Securities Commission) and unlisted entities (issued by the Comptroller of Companies). Each of the codes has different requirements. From observation of SOE annual reports, it is clear that there is limited compliance with either of the codes. In Djibouti, a code for good governance of SOEs was passed in 2016, but the code has still not been fully implemented. In Egypt, a corporate governance guideline was issued in 2006, but the use of the guidelines appears to be limited. Egypt has made progress in its legal framework for SOEs under the Public Business Sector Act. However, here too, there is scope for improvement. Possible improvements could include a framework for the appointment of board members, further improved disclosure practices, as well as requirements to account for public service obligations. Morocco's legal and regulatory framework for SOEs is relatively robust, and it has undergone significant improvements over the last decade. A Code of Good Governance Practices for Public Establishments and Enterprises was established in 2012, and it is currently (mid-2023) in the process of being updated. In Tunisia, Guidelines of Good Corporate Governance were issued in 2012. However,

again, there is limited evidence of actual usage. The issue of implementation and, in particular, creating incentives for reform (reducing disincentives) needs to be considered carefully in any future reforms.

Separation of the state's shareholder function from its policy and regulatory functions

In MENA countries, it is common for the ownership and regulatory responsibilities of the state to be combined within line ministries. The OECD recommends that policy, regulatory and shareholder functions be separated to reduce the potential for conflicting objectives within one body. In MENA, line ministries frequently act simultaneously as owners, policy makers, and regulators. They do so by exercising key ownership functions, including the appointment of the Chief Executive Officer (CEO); the drawing up and approval of SOE budgets; the development and approval of SOE strategies; setting tariffs; and otherwise devising regulations. Several countries have taken steps to separate the ownership function from other state functions. This includes Jordan and Oman (where ownership is centralized in a holding company) and Morocco and Djibouti (which have taken steps to further centralize ownership and coordination functions under the new ownership agencies, the *Agence nationale de gestion stratégique des participations de l'État* (ANGSPE) and the *Secrétariat Exécutif en charge du Portefeuille de l'État* (SEPE). In the jurisdictions without centralized ownership, that is, Egypt and Tunisia, the challenges appear particularly pertinent (although in Egypt's case, the recently approved State Ownership Policy indicates that a stronger separation of ownership and regulatory functions is necessary). More broadly, examples of potentially conflicting functions can be found in several countries, where ministries are responsible for a wide range of functions including: (i) the approval of performance agreements, annual business plans, budgets, financial statements and wage levels; (ii) the deliberations of the board of directors; and (iii) the development of regulatory texts. Further efforts at distinguishing between the state's key functions should be considered as part of any future framework reform.



V. STATE OWNERSHIP ARRANGEMENTS

The OECD Guidelines on SOEs recommend organizing the state ownership function in a manner that promotes efficient, transparent, and accountable management of SOEs. The guidelines encourage the establishment of a centralized ownership entity or a coordinating body, staffed by professionals with relevant expertise, to oversee and administer state ownership. This entity should develop and communicate a clear **ownership policy**, outlining the state's objectives for the SOE portfolio, the ownership rationale, performance expectations, and governance principles. In addition, the guidelines emphasize the importance of continuous evaluation and monitoring of SOE performance, as well as maintaining open channels of communication between the ownership entity and relevant stakeholders, including the public and legislature.

Practices in the MENA region are evolving. In most countries, SOEs have historically been managed using a decentralized model. Thus, the political economy of reforming these arrangements (to a more centralized model) can be challenging. Decentralized models, in themselves, act as a constraint on any additional reforms (such as establishment of ownership policies), which require coordinated ownership. MENA countries are making progress on this issue at different rates and using different models.

Decentralized ownership arrangements

Ownership arrangements are generally fragmented with line ministries typically playing the main role in directing SOEs. Most MENA countries are familiar with the recommendation of the OECD to establish centralized ownership arrangements and, at a minimum, coordinating mechanisms to help improve SOE oversight and governance. Yet, the implementation of this recommendation has been measured. The main oversight bodies are line ministries, the Ministry of Budget, and the Ministry of Finance. These ministries focus heavily on monitoring compliance with budgets, contractual obligations, and the political objectives of the government. However,

line ministries do not generally take a shareholder perspective on SOEs. They tend to take a view driven much more by the achievement of policy objectives. In Tunisia, where ownership is decentralized, a recent study (*Livre Blanc*)³⁶ reported that line ministries lack the resources and operational skills to take financial and business decisions. Egypt currently has a hybrid state ownership model combining centralized ownership for some companies (exercised through state-owned holding companies), and decentralized ownership in other cases.

The development of ownership arrangements is generally moving towards greater centralization, and the use of the holding company model has been adopted in Oman and Jordan. Holding company structures are used with varying degrees of success throughout the world. There are advantages and disadvantages to this structure (see box 1). Looking at various models in other jurisdictions, Oman has recently centralized almost all ownership through the establishment of the overarching Holding Company, the Oman Investment Authority. The OIA has been granted the mandate to develop all of the financial and governance rules for the SOEs within their remit. To date, they have established a Corporate Governance Code, a Procurement Code and investment rules. The entities themselves are housed within several industry-based holding companies that are themselves subsidiaries of the OIA. This structure is meant to: (i) streamline the governance and ownership; (ii) allow for specialization in oversight; and (iii) allow industry-specific modes of ownership/oversight to be developed. In Jordan, a holding company structure has also been adopted, but there is little visibility about how it performs its role. In fact, in both countries, greater transparency about the role, functions and performance of the ownership holding company would engender greater confidence in the merits of this structure.

The remaining countries are moving toward greater centralization. In Djibouti, a new body tasked with overseeing the state's portfolio at the central level should

³⁶ Government of Tunisia (2018) : *Livre Blanc – Rapport de synthèse sur la réforme des entreprises publiques en Tunisie*.

help to gather information and provide centralized oversight (although it had not begun operation at the time of this writing). Morocco stands out in the MENA region as the only country with a central general government coordination body exercising the state ownership role. It recently established the state ownership agency (ANGSPE) which, when fully operational, will have the classic responsibilities of an ownership entity, including: (a) developing the state shareholder policy; (b) developing and implementing an ownership rationale, as well as considering divestitures; (c) fulfilling the fiduciary duties of an owner; (d) professionalizing the

governance of SOEs; (e) monitoring SOE performance; and (f) reporting on its own activities, among others. The ANGSPE was established in recognition of the urgent need for budgetary reforms.³⁷ In Tunisia, the establishment of a centralized and independent entity has been envisaged in numerous reports, but no legal and operational steps seem to have yet been taken. All the individual SOE governance reports suggest that current oversight and institutional arrangements do not generally allow for a coherent and coordinated framework. Centralized ownership entities, though recommended, are a relatively new concept. Thus, it

Box 1: Advantages and Disadvantages of State-Owned Holding Companies

Advantages:

1. Centralization: State-owned Holding Companies (SOHCs) can centralize the ownership function, enabling the state to manage its portfolio of SOEs more effectively and consistently.
2. Professionalization: By creating a specialized body, the SOHCs can attract professionals with relevant expertise, leading to better governance and management of SOEs.
3. Clearer separation of roles: The SOHCs help separate ownership and regulatory functions, reducing conflicts of interest and ensuring impartial oversight.
4. Economies of scale: The SOHCs can leverage economies of scale in areas such as procurement, financing, and shared services, leading to cost savings and operational efficiencies.
5. Improved performance monitoring: The SOHCs facilitate better performance monitoring and benchmarking by allowing for a more coordinated approach.

Disadvantages:

1. Bureaucratic layer: The creation of a SOHC can add an additional layer of bureaucracy, potentially resulting in slower decision-making and reduced agility.
2. Political interference: The SOHCs can be susceptible to political interference, which may lead to suboptimal decisions and inefficiencies.
3. Complexity and opacity: The structure of the SOHCs can be complex, potentially reducing transparency and making it difficult for stakeholders to hold SOEs accountable.
4. Risk of monopoly power: Consolidating SOEs under a SOHC may create market concentration, which could lead to monopolistic behaviour and market distortions.
5. Legal and regulatory challenges: The establishment of a SOHC may require adjustments to existing legal and regulatory frameworks, which can be a complex and time-consuming process.

Source: Authors.

³⁷ Interestingly, plans are underway for the ANGSPE to have an advanced governance structure. According to its founding law, by 2026, it will take the form of a corporatized entity. It will have a board of directors chaired by the Minister of Economy and Finance with five state representatives and three independent directors.

will take time to become accepted and operational. Although centralized oversight would represent a significant change from current practice in some countries, there could be significant benefits in making this a priority for reform. In Egypt, although there is some evidence of further decentralization, the recently approved State Ownership Policy may provide impetus for a more centralized model.

Political influence on SOEs

Although circumstances vary from country to country, in general, it is common for the state to be involved in the management decision-making process. There are two issues at hand here. The first is micro-management, or the excessive involvement of the state in the management of the enterprise. Good practice suggests that boards should be autonomous. They should have the capacity to direct and oversee management in the achievement of their business objectives, while also being accountable to owners for the final outcomes. The second is political interference, whereby decisions are taken based on political imperatives. Those imperatives may have nothing to do with the business goals of the enterprise or even the achievement of public service obligations. Although policy directions are a legitimate prerogative of the state, they should be channeled through boards. They should also be subject to formal decision-making processes with boards exercising their legal duties under company law to act in the best interest of the company. In MENA, interventions into the management of SOEs and politicized decision making are common. The establishment of clear and formal decision-making rights and thresholds (for owners, boards, and managers), as well as a defined process for how to communicate policy objectives to the SOE should be considered essential goals.

Throughout the region, it is common for boards to be composed of civil servants who are generally not encouraged to take independent decisions and who are obligated to implement instructions from their political superiors. In Jordan, the case of the electricity

company, the National Electric Power Company (NEPCO), is informative. The managing director of the company as well as the board of directors are appointed by the Council of Ministers. According to NEPCO's 2022 annual report, the Board of NEPCO currently has five members, including the Chairman and the general secretaries of the Ministry of Finance, and Ministry of Energy and Mineral Resources. The Managing Director reports to the Board. The Cabinet of Ministers appoints NEPCO's Board of directors as well as its Managing Director. Given the sector structure, gas supply interruption during 2011-2015, increasing cost of generation, and the tariff setting methodology by the regulator, NEPCO has accumulated significant financial losses. In Djibouti, boards are dominated by public sector employees and, in some cases, ministers. In addition, they are generally highly politicized. The goals of autonomy, responsibility and accountability can be achieved, in part, by enforcing clear decision-making processes and thresholds (as recommended above). These are supplemented by training of SOEs and government officials regarding the distinct roles of management versus boards and owners. Ultimately, however, the de-politicization of decision making depends on the political powers supporting the autonomy and independence of boards, as well as the implementation of formal performance contracting.

Rationales for state ownership

Rationales for continued state ownership, as recommended by the OECD Guidelines, are comparatively rare. It is considered good practice for a country to define its rationale for state ownership. Ownership rationales are often included in ownership policies, as recommended by the OECD Guidelines (See Ownership Policy below). A rationale for state ownership typically requires a number of conditions to be fulfilled for state ownership to be justified, including: (a) that the private sector cannot reasonably be expected to fulfill the desired functions of the SOE equally as effectively; (b) a market failure, such as a natural monopoly (common in network industries with high barriers to entry); (c) strategic sectors such

as defense; and (d) infant industries³⁸ which, due to their absence or newness, may require protection for a limited period of time from stronger and more established competitors. The prevalence of statewide multi-year planning frameworks in the region provides a foundation for developing ownership policies. For instance, in Oman, the Vision 2040 framework could provide the basis for developing an overarching SOE ownership philosophy tied to the country's strategic objectives, as established through Vision 2040. The OIA is working to integrate these strategic objectives into individual company objectives, but there is a need to also do this at the portfolio level as well.

Reshaping the state's ownership portfolio

Most MENA countries do not subject the state's portfolio of SOEs to a regular evaluation or even systematically consider the justifications for continued state ownership of SOEs. Although state ownership is justified under certain conditions, international good practice suggests that the state evaluate its portfolio of SOEs on a regular basis to decide whether there is still a need for continued state ownership of individual enterprises. This process does not typically occur in MENA. Indeed, country reports suggest that many enterprises do not have a clear rationale for state ownership. There are many examples of state ownership where the private sector is generally considered better suited to provide the needed products and services (for example, for hotels, construction, manufacturing and other sectors). The presence of the state in competitive sectors suggests that the degree of "competitive neutrality" or fair competition between the private and public sectors warrants further examination. It also suggests that MENA states should regularly evaluate their portfolios of government-related enterprises to assess if the need for continued state ownership persists.

One of the techniques that is recommended to begin to reshape the state's ownership portfolio is to categorize government-related entities (based on criteria, such as whether they operate in competitive sectors, financial versus non-financial SOEs, size, budgetary impact, and other factors) in order to develop tailored strategies based on a rational system of classification.

Privatization should be considered as a potential policy solution to many of the governance challenges SOEs face, subject to a jurisdiction having the institutional capacity to manage the post-privatization regulatory environment. For instance, where SOEs are underperforming, or present significant fiscal risks, then privatization (or other divestment options, such as public-private partnerships [PPPs]) can sometimes provide a framework for addressing these challenges. When considering private sector options, it is important that the government understand the post-privatization industry structure and requisite regulatory frameworks. Any private provision of services / goods should involve a genuine risk transfer to the private sector; this will in turn depend on: (i) the effectiveness of the sale process in allocating risks; (ii) the institutional capacity of the government post-privatization to manage and regulate the industry structure; (iii) the complexity of the industry to which the sale relates. It follows that the validity of using private sector involvement as a means of addressing SOE governance or performance challenges will vary by jurisdiction and SOE.

Ownership policies

Few countries in the MENA region have a clearly identifiable ownership policy. Best practices and OECD guidelines suggest that countries should develop and disclose their SOE ownership policy. They should define the objectives of the state as an owner, as

³⁸ It is commonly argued that infant industries require protection from international competitors until they are able to compete on their own. Views regarding the validity of infant industry protection differ. Arguments that are commonly proffered in favor are to protect a new enterprise until it can compete on equal grounds, promote national security and reduce reliance on production from abroad. However, infant industry protection may serve to encourage and perpetuate inefficient industries and reduce incentives to compete. Infant industry protection may also raise costs for consumers compared to the cost of imports. Furthermore, it is often difficult to roll back protections once they have been granted due to vested interests. Finally, infant industry protections have been provided by virtually all major economies at some point in their economic history to protect their domestic production.

well as the institutions and means by which the state achieves its objectives. Beyond defining the goals of state ownership and an ownership rationale, ownership policies should describe the roles and responsibilities of the different institutions tasked with the ownership responsibilities of the state. An ownership policy serves as a crucial tool for governments, ensuring alignment with national priorities, promoting good governance, and clarifying the state's roles as both an owner and regulator. By providing a foundation for performance management and fostering transparency and accountability, it enables stakeholders to effectively monitor and evaluate SOEs. Furthermore, an ownership policy facilitates fair competition and a level playing field with private enterprises; supports long-term value creation through strategic planning and innovation; and enhances stakeholder engagement, ultimately fostering trust in the government's management of SOEs.

In practice, there is no single model for how to develop an ownership policy. Even if good practice suggests that an ownership policy be in one single document, it is not uncommon for various aspects to be regulated by different legal instruments. In many MENA countries, the elements of an ownership policy can be found in prime ministerial circulars, decrees, and other laws which specify the financial control rights of the state over the SOEs. In Djibouti, for example, there is no single policy; rather, elements can be found in various laws and decrees. The result of this fragmented approach is that it is sometimes unclear who has the responsibility for ownership activities, including monitoring and reporting. In Morocco, there is currently no standalone consolidated ownership policy, but the development of a State Ownership Policy (SOP) is an explicit mandate of the ownership agency, ANGSpe. Tunisia has no single ownership policy stating the rationales of state ownership or communicating the public policy objectives of SOEs. However, existing commitments in strategies and various parts of legislation provide a strong basis for issuing a consolidated document. Egypt's SOP, approved by President Sisi in December 2022, represents the region's first stand-alone and comprehensive SOP. If further operationalized – especially in terms of its corporate governance and market neutrality commitments – it provides a very promising framework for SOE reform in Egypt. It is also

a good example for other countries in the region. One of the key recommendations for MENA countries is to have a unified ownership policy that defines the basic parameters of SOE governance and oversight.

Almost as important as the ownership policy document is engaging in an open and transparent process to define and establish the underlying tenets of the policy. These tenets would include, for instance, the overall state objectives of ownership and rationales for continued ownership of SOEs. A comprehensive process would include not just government agencies and SOEs, but wider society, including the public, the legislature, minority shareholders, financing bodies, employees, and suppliers. Engaging stakeholders will promote transparency, trust, and accountability in the ownership framework. It will also help to ensure that diverse perspectives are considered, leading to more informed and balanced policies. Furthermore, stakeholder engagement fosters a sense of ownership and commitment, enhancing the likelihood of successful policy implementation and long-term effectiveness. The process of preparing Egypt's SOP followed these principles, including by inviting comments from the public, and by having several consultative – often public – meetings with stakeholders.



Aggregate reporting

Aggregate reporting from a shareholder perspective, as recommended by the OECD Guidelines, appears to be rare, although good emerging practices can be identified. This type of reporting is usually done by a centralized ownership entity (or an SOE coordinating body). It is not surprising that aggregate reporting is limited in MENA since few centralized ownership entities exist. Also, SOEs more typically report to a variety of state institutions. In some cases, basic information about the extent of state ownership is not even available to the state as the owner. Fiscal authorities are, arguably, most advanced in their monitoring throughout the region because of the interest that governments have in the impact of the SOEs on state budgets. Morocco's Department of Public Enterprises and Privatization takes a broad approach in its annual report. Several good and improving practices can be observed regarding aggregate reporting on the SOE portfolio. In Oman, the OIA annual report is providing

high-level data on the portfolio of companies, although at this stage it is mostly qualitative. In Egypt, the Business Sector Information Center (BSIC) has taken important steps toward providing summary information on SOEs and making this information available online. Furthermore, the Ministry of Finance's issuance of aggregate reports on SOEs in 2018 and 2019 marked a significant improvement in transparency. Since 2019, the Ministry of Finance in Tunisia has published an annual report on SOEs, which it annexes to its Budget Law. That report focuses on the fiscal impact of SOEs, but not on their overall performance or governance. Throughout the region, aggregate reporting from a shareholder perspective could be developed further to provide both the state and the public with the information needed to hold SOEs and their governors more accountable for SOE performance. Aggregate reporting from a fiscal perspective should refer to the overall fiscal impact of SOEs (not just their impact on the budget), including the impact on the state's balance sheet.



VI. PERFORMANCE MANAGEMENT FRAMEWORKS

The OECD Guidelines on SOEs recommend the implementation of effective performance management frameworks to ensure that SOEs operate efficiently and achieve their defined objectives. These frameworks should encompass clear performance targets and indicators. They should also be aligned with the ownership policy, taking into consideration the specificities of each SOE. There should be regular monitoring and evaluation of SOE performance, with benchmarking against comparable private sector companies or industry standards whenever possible. Additionally, the frameworks should promote transparency by mandating public disclosure of performance results, as well as fostering accountability through SOE-level performance agreements. By focusing on performance management, ownership entities can drive continuous improvement and value creation within SOEs, while also minimizing the risk of market distortion, thus ensuring a level playing field for all market participants.

It is common throughout the region for a variety of independent institutions to monitor SOEs, but without one body able to provide a comprehensive or exhaustive view of the SOE sector. As noted, many countries do not have a centralized “ownership entity” as recommended by the OECD. However, of the six reviewed countries, Morocco has established a new centralized ownership entity, the ANGSPÉ, and Jordan and Oman have taken steps to centralize ownership through a SOE Holding Company. The reforms in Oman, which involved the transfer of almost all SOEs to the Oman Investment Authority, provide an example of how reform might proceed in the region. As a holding company, the OIA is a centralized owner that has already developed a performance management framework, with benchmarks based on a balanced scorecard approach. Their system is still evolving, with the challenge being to develop a streamlined, broad-based, target-setting and benchmarking process that can apply across a very large and disparate group of SOEs. As noted, Oman has chosen to structure its 170 SOEs under a series of nine industry-themed, sub-holding companies in an attempt to make this process more manageable. This structure may create some competition concerns (particularly in industries where SOEs dominate), but it will likely lead to some efficiencies

in the performance management arrangements. Jordan has also established a Holding Company, the GIMC, to oversee the majority of SOEs in Jordan. Again, this entity would be well-placed to implement a comprehensive performance management framework. During the preparation of the SOE Governance Review of Jordan, it was unclear the extent to which the GIMC was performing this function.

In the absence of an ownership entity, state institutions do not usually take a shareholder perspective concerning the performance of SOEs, although ministries of finance often take a financial view of the SOEs. In Egypt, most SOEs appear to report to their respective line ministries about operational and financial performance, as well as the implementation of approved business plans containing specific performance indicators. In addition, SOEs must report financial results to the Ministry of Finance. A representative of the MOF is mandated to attend shareholders’ meetings for all holding companies. The focus of the ministry’s representative is typically limited to the issue of dividends and financial exposure, but not to issues of strategy or performance. In Morocco, a new law introduces several potentially strong monitoring tools, but these are not systematically extended to all SOEs. In Tunisia, a proliferation of organizations exercise oversight in their specific area of interest. However, there is no single, comprehensive system for monitoring performance, although performance contracts are used for some state-owned banks and SOEs. Throughout the region, ministries of finance will typically monitor budgetary impacts, and banking regulators will monitor the stability of state-owned banks. Overall, there is considerable scope for a more systematic approach to performance monitoring, management, and goal setting throughout the region.

A core challenge in assessing SOE performance is to disentangle the multiple objectives of different state institutions and SOE stakeholders. Multiple and sometimes conflicting objectives make it difficult to hold SOE management and boards (and even the state as an owner) accountable. Throughout the region, the strategic objectives of SOEs, the performance outcomes and specific key performance indicators (KPIs) are not generally set down formally or sufficiently

quantified. Several measures can be taken to clarify and harmonize SOE objectives. In particular, it is important to have better accounting of the costs of PSOs. This can help provide crucial insights into the costs and benefits of PSOs, and it should help enhance accountability regarding outcomes. The profitability and

financial performance of SOEs should play a prominent role. Arguably, it should be at the forefront, given that financial performance is essential to the longer-term sustainability of the enterprise. Such a focus can help SOE management prioritize their efforts and support better fiscal management.



VII. BOARD STRUCTURES AND FUNCTIONING

Creating effective functioning SOE boards is one of the greatest challenges that jurisdictions face in managing SOEs. Done correctly, it is also a reform with significant chances of achieving improved performance. In MENA, as in other regions, public servants and current or former politicians can be overrepresented on SOE boards. Often this practice reflects a form of patronage or reward. However, it can also be an attempt to minimize the agency costs associated with independent management. Governments, distrustful of managers, may seek to appoint Board members that they feel will best implement their interests. Unfortunately, boards with excessive government representation tend to lack the full range of skills necessary to effectively oversee complex commercial operations, with a concomitant adverse impact on commercial performance. A better approach, as advocated by the OECD Guidelines, is to appoint professional boards. They can then give them the necessary autonomy to perform their role, as well as to control the agency costs through effective performance monitoring, strong disclosure requirements, and effective ownership oversight. It follows that improving Board composition and performance cannot be done in isolation. It also requires that governments effectively reform their ownership arrangements, disclosure requirements and performance monitoring frameworks.

Board structures

SOEs may have a variety of board structures depending on their legal status, which can make it difficult to uniformly implement good governance practices. In almost all cases, the relevant laws contain provisions regarding the minimum and/or maximum number of board members, as well as whether single or dual board structures should be adopted. In Egypt, for example, the company law provides the legal framework for both public and private companies, including military-owned SOEs. It also prescribes, among other things, a single-tier board with a minimum of three board members.

Laws, governance codes, and listing rules can go further than mandating the structure of the Board; they can extend to mandating minimum non-executive directors, term limits, independence requirements, and board committee structures. For

instance, in Oman, the law requires all directors to be non-executive. It also requires that directors serve a maximum of two three-year terms. The governance code mandates strict requirements to qualify as independent, and it requires the establishment of an audit committee. In Egypt, the Public Business Sector Law applies to SOEs explicitly under the scope of the law and prescribes board practices. SOEs listed on the Cairo Stock Exchange are subject to the Capital Market Law, which stipulates additional requirements in terms of board structure and functions beyond those found in company law. Similarly in Jordan, there is a code for unlisted companies that details the functioning and structure of boards, as well as a separate, more prescriptive code issued by the Stock Exchange for listed companies. In Tunisia, board functions and structures are set out in law, which assigns them a mostly consultative role with key authorities devolved to supervisory authorities. Recent decrees have changed board structures and roles by defining principles related to the selection, removal, and evaluation of board members. A major change from prior decrees is that the number of independent board members had originally been set at a minimum of two, whereas it has now been rolled back to cap the number of independent board members to a maximum of two. Overall, the different types of board structures within countries could stand to be harmonized along with the legal forms of different types of enterprises to facilitate monitoring and reform (See legal forms above).

Board nominations

Board member nomination processes are not generally formally articulated or transparent, and they do not necessarily yield the candidates best suited for board posts. Decisions about board membership in most MENA countries tend to be made at the highest level of the state. They may involve finance and line ministries. Although the background of candidates is often considered, the decision is generally determined based on political suitability. In most of the reviewed countries, the rules and procedures for nominating and appointing SOE board members are not based on pre-established professional criteria, and there is no formal selection process. Oman is seeking to move toward a more structured nomination process, but it is not yet fully formed.

The absence of transparent and competitive SOE board nomination processes in MENA countries, together with the limited presence of independent board members (see independence below), significantly limits the ability of SOE boards to exercise objective and independent judgement without political interference. Some of the shortcomings in SOE performance in MENA can be traced, at least to some extent, to board nomination processes that do not yield the best-suited candidates for board posts. It is critical that an appropriate skills and competence mix is achieved for members of boards and committees. Good practice suggests that a key focus of SOE reform should be: (a) the transparency and quality of the board nomination process; (b) ensuring that nominations are made based on competence and experience; and (c) ensuring that there is a clear distinction between management and board functions.

Board composition

The composition of boards in MENA tends to be skewed heavily toward high-level public sector profiles. The preponderance of civil servants and political figures on SOE boards illustrates the primacy of the political agenda over the economic agenda — and even social performance. Being a high-profile public officer remains a primary criterion for nominating SOE board members, with private sector experience, business skills and technical competency being secondary requirements. Many MENA countries acknowledge the benefits of good board composition, merit-based nominations, apolitical boards, skills, and independence. However, decisions related to board composition remain deeply political and are generally out of the control of the SOE. In Djibouti, boards often have ministers who retain ultimate decision-making authority. To exacerbate matters, substitutes are often sent to replace ministers who, in the absence of the minister, are unable to make decisions or propose any concrete actions. In Jordan, ministerial representatives on Boards are standard, often including both the Ministry of Finance and the relevant line ministry. By contrast, Oman is making significant steps toward a structured, merit-based approach to

board composition. For example, (i) the Code of Governance requires all directors to be non-executive; (ii) Ministers and Ministry leaders cannot be represented; and (iii) board nominations are being made using a skills matrix. In Morocco, the Supreme Audit Institution carried out a comprehensive evaluation of its portfolio in 2016. It concluded that in a sample of SOEs, board composition needed to improve. Consequently, there is an awareness of the importance of an effective, professional, and independent board as an essential part of building a well-governed, autonomous, and financially sustainable SOE. Nevertheless, the boards of some strategic SOEs continue to be dominated by ministers and their representatives. In Egypt, board composition and board member backgrounds and qualifications vary widely, with listed SOEs coming closer to good practice. In Tunisia, boards are almost entirely composed of state representatives from ministries or public bodies, as well as former public official retirees. In 2018, the *Livre Blanc* report³⁹ indicated that “SOEs boards lacked objectivity, specific qualifications and competences required to fulfill their duties and that risks of conflicts of interest were obvious”. Recent changes in law are a welcome improvement, but they maintain the stronghold of supervisory authorities and the total lack of independence of SOEs boards. A commitment to the de-politicization of boards and improved board composition would present a significant opportunity for improvement throughout the MENA region.

Board duties and roles

Many MENA boards do not fulfill the duties and roles generally expected of them in accordance with good practice. Their work is still commonly associated with the checking of compliance with sector-specific policy objectives and the financial constraints set by the state. Furthermore, the duty of board members is often understood to be directed to the state and not to the SOE. Best practice suggests that boards exercise a variety of different roles, most important of which are: (a) guiding the management in setting the strategic direction of the enterprise and developing strategic plans; (b) agreeing to KPIs with the management and

³⁹ Op. cit.

monitoring management's performance against the KPIs; (c) selecting the CEO and engaging in succession planning; (d) monitoring the reporting and control environment, and ensuring that systems for control and risk management are in place and functioning; and (e) reviewing and improving their own governance practices. At the same time, boards are expected to respect the different roles and interests of boards, management and owners. In practice, one of the greatest challenges for boards is to focus on strategic issues as opposed to the minutiae. This last challenge is reported globally as a major challenge in both private and public companies. The extensive training of civil servants and SOE boards concerning the roles and duties of a modern board will be necessary to effect a longer-term change in governance practices. The training of civil servants in good governance practices is essential since a lack of knowledge of good practices in SOE governance is often a roadblock to reform.

Board autonomy and decision-making thresholds

A common problem in MENA countries is the limited autonomy afforded to boards. The OECD Guidelines recommend giving boards decision-making autonomy while, at the same time, ensuring that boards remain fully accountable to owners and the public. Often, the decision-making authorities and autonomy of boards and management are not observed due to a lack of formal decision-making authorities and thresholds. Sometimes, thresholds are clear, but are set so low as to trivialize the work of the board. One of the classic results of this is that boards disengage because they are, in the end, unable to act independently or have any meaningful impact on the SOE. Throughout the region, this is illustrated by the inability of boards to choose the CEOs of SOEs. In Jordan, for instance, CEOs are often appointed by the relevant Minister or, in the case of the NEPCO, by the Prime Minister. Similarly, in Tunisia, ministries are deeply involved in decision-making and activities that are normally reserved to boards and management. For example, Tunisian ministries review all human capital and organizational decisions such as: organizational charts, special staff statutes, job classifications, compensation plans, conditions of appointment, recruitment programs, performance

monitoring systems and even overseas travel. Moreover, line ministries have the power to approve all board decisions before their enforcement. In Egypt, in practice, SOE boards are rarely empowered to appoint or dismiss the CEO, which makes it difficult for boards to fully exercise their function and take responsibility for SOE performance. Overall, such practices serve to reduce the capacity of boards to fulfill their duties and responsibilities, as well as the ability of SOEs to operate effectively in a competitive environment. Systems should be developed to simultaneously devolve authority and responsibility, while better holding boards to account for outcomes.

Nevertheless, there are some moves being made in selected jurisdictions to improve the autonomy of Boards.

In Oman, it is mandated that at least 2 directors must be independent. Board performance is being assessed using a balanced scorecard approach, and members are being chosen for their skills. In this context, a greater focus is being placed on the commercial performance of the SOE. In Morocco, efforts have been made to provide greater autonomy to both the boards and management of SOEs by reducing *a priori* approvals. In the past, in SOEs subject to a priori control, ministries were authorized to give final approval to all budgets, staffing, organization charts, procurement policies, credit and borrowing decisions, and the distribution of profits.

Independence

Independence on SOE boards is recognized as an important goal, but it remains a challenge.

Best practice suggests that independent board members and independence of mind are essential for a well-functioning board. In practice, nominating a greater number of independent board members conflicts with the often-traditional use of boards, which is to reward political allies and civil servants, and to exercise direct control by the state on important decisions relating to investments and expenditures. Relying on independent thinkers to make decisions on the behalf of the state represents a major shift in mentality, as well as a change in the understanding of what constitutes good governance. However, change is possible. In Morocco, independent board members became mandatory under

successive amendments to the Company Law in 2020 and 2021. This occurred even if, in practice, few SOEs have appointed independent board members. Oman has similarly mandated a minimum of 2 independent directors on each board, and it has specified strict criteria for what constitutes an independent member. In Tunisia, the independence of SOEs boards seems to be not effective. Even though the SOE Corporate Governance Code recommends that 25 percent of the members of SOE boards should be independent, few have implemented this recommendation. Tunisian bank boards are expected to have at least two independent board members and limit themselves to one executive board member. Greater independence of SOE boards could be recognized as a key contributor to better performance and risk management.

Gender balance

Although gender balance is not considered to be as important a goal as in other countries, there is increasing recognition in some MENA countries of its potential benefits. Despite the relatively recent revision of legislation governing board composition in Egyptian SOEs, gender balance was not explicitly addressed. In Morocco, public debt issuers require that SOEs make disclosures about board diversity (independence and gender) in accordance with the Capital Market Authority's disclosure rules. Integration of independent board members and board diversity became mandatory under successive amendments of the limited liability company Law in 2020 and 2021. By 2024, women should represent 30 percent of board seats, and committees should include at least a woman. By 2027, the proportion should reach 40 percent. Companies not complying with the new board composition rules face sanctions of nullity of board appointments and non-payment of directors' attendance fees. In Tunisia a decree from 2022 stipulates board diversity requirements.⁴⁰ It suggests that gender representation should not fall under 40 percent. Overall, MENA countries should explore the potential benefits of a further diversification of views

about SOE boards, with the goal of improving the quality of their deliberations.

Conflicts of interest

Systems for managing conflicts of interest are in place in many countries, although there is no data to demonstrate their efficacy or the extent to which transactions occur when parties have conflicts.

A conflict of interest occurs when an individual or organization has multiple interests, one of which could corrupt their motivation in a transaction. Conflicts of interest commonly result from family interests, ownership in other companies, gifts from friends or business partners, or multiple places of employment. An example is using one's official position to secure a contract for a private consulting company one owns to obtain a job for a relative. SOEs are particularly vulnerable to abuse under conflict-of-interest conditions because of generally lower transparency requirements, less stringent governance practices and their subjugation to political powers. Conflicts of interest are not generally prohibited and cannot be avoided completely. What is essential, however, is that any decision taken where a conflict of interest exists should be taken at "arm's length". An arm's length transaction is a transaction in which parties act independently and have no relationship to each other. State-owned banks can be particularly vulnerable to conflicts of interest since boards and executives often make direct lending decisions.

Many MENA countries have procedures in place to manage conflicts of interest, but their efficacy remains to be demonstrated. In Djibouti, Decree 176 sets out procedures that define how board members should act in a situation of conflict of interest. In Oman, the Code of Governance sets out the process to be followed by board members in the case of a conflict, including mandatory disclosure. Where ongoing conflicts are unavoidable and significant, the code requires a director to resign. In Morocco, conflicts of interest are viewed as one of the greatest challenges of ownership

⁴⁰ Presidential Decree no. 2022-303 of March 29, 2022.

because state representatives can fulfill board mandates while simultaneously exercising board oversight. Such situations have been addressed under an amended Law on State Control, but conflict situations can still arise. In this respect, recommendations are being considered to require board members to complete annual conflict-of-interest statements and report any potential conflicts of interest prior to each board meeting. In Tunisia, the Livre Blanc report of 2018 suggests that SOE boards are subject to obvious conflicts of interest, even though board members must disclose in writing any direct or indirect interests they might have related to contracts or operations performed with the SOE. Thus, conflict-of-interest requirements are in place, but compliance and enforcement practices are unclear. Throughout MENA, there may be benefits to examining how to better implement and enforce conflict-of-interest policies within SOEs.

Board evaluations

Overall, the use of annual board and governance evaluations to improve the quality of governance practices is limited in MENA. Best practice suggests that boards engage in annual performance evaluations that should, ideally, lead to remedial action plans and an

iterative process of board improvement. In Oman, board evaluations are required under the Code of Governance, both individually and as a whole. These should be based on pre-set KPIs. In Djibouti, board performance is not evaluated. In Egypt, board evaluations do not appear to occur, and an external assessment of boards is difficult due to limited publicly available information. In Morocco, board evaluations are sporadic, and weak board practices persist. However, recent audit reports and other reviews have brought this issue to the attention of policy makers. Most of the practices that need to be improved in Morocco are related to board functioning such as: (a) meetings held without the required quorum; (b) chairing of meetings by an unauthorized member; (c) a lack of respect of the requirements for communicating information to board members; (d) a lack of rules of procedure and codes of conduct; (e) a lack of respect of the minimum number of meetings of specialized committees; and (f) the use of signed minutes without actually holding board meetings. Even if many MENA countries are generally aware of weaknesses in SOE board practices, improvements could be encouraged by rigorous annual benchmarking, as well as the development of remedial annual action plans to close the gaps with good practice.



VIII. FINANCIAL REPORTING, ACCOUNTABILITY, CONTROL, AND TRANSPARENCY

Timely, complete, and fair disclosure of material matters

An often-heard complaint in the region is that the quality of disclosure by SOEs is poor, and that many large SOEs do not disclose anything but basic company information. Much of the thrust of good practice recommendations, such as the OECD Guidelines, is to promote accountability through transparency and disclosure. Good information is equally important for investors, banks, citizens, and the state. Indeed, it is considered essential to incentivize performance, accountability, and effective governance. Yet, in many MENA countries, SOE affairs are shrouded in confidentiality with limited accountability to the state and the public. SOE performance can be so politically sensitive that there are strong disincentives to making their true condition public. Furthermore, reports are often made available only to line ministries and other state bodies, but they are not disclosed to the public. Generally, across the region, listed SOEs are the main entities likely to publicly release their financial statements, as this is often a requirement of the listing rules. In Oman, select SOEs do publicly release their financial statements, but it is more the exception than the rule. The OIA has made efforts to provide more information about its portfolio of SOEs in its Annual Report. However, to date, that information has been high level and largely qualitative. Similarly, in Jordan, there is only piecemeal public disclosure. In Egypt, recent legal changes have strengthened the reporting requirements for some SOEs, but disclosure practices for non-listed SOEs remain inadequate. Likewise, in Tunisia, transparency and information disclosure is limited, thus reducing accountability and performance monitoring.

Timeliness in the release of financial statements is also a problem in MENA. For example, Djibouti faces serious challenges in the quality and timeliness of reporting. The delay in closing annual accounts can range from three to five years, thus making annual reports effectively useless as decision-making tools. The reason for such delays is often a reticence to be open about the financial condition of SOEs. It is not unusual for the financial information necessary to make informed decisions to be unavailable—even for the state. An absence of good information reduces the capacity

of the owner to develop sound policy and exposes countries to significant risks. Without good information, it becomes impossible to monitor the performance of the enterprise or its board, to set targets—or to have a rational process for allocating the resources necessary to achieve goals. Better disclosure practices are considered a key avenue of reform and central to holding the SOE to account. Minimum standards of disclosure for larger SOEs should be equivalent to that of listed firms (that is, the annual financial reports prepared under the IFRS and audited according to the International Standards on Auditing [ISA]). The SOEs should also make non-financial disclosures covering governance, environmental impacts, risk management and other issues that are now considered standard for listed companies. Special approaches will need to be developed for smaller SOEs.

The use of International Financial Reporting Standards (IFRS)

The use of IFRS within the region can be strengthened. Best practice suggests that SOEs produce their annual financial reports by using generally accepted accounting standards, and that SOE disclosures be at least equivalent to those of good practice for private companies. It has been shown globally that the use of national alternatives to the IFRS can obscure the true financial condition (and risks) of SOEs, as well as the capacity of the state and other stakeholders to make informed decisions. In both Jordan and Oman, the IFRS is mandatory and apparently well implemented, although the absence of public disclosure of financial statements in both jurisdictions makes this difficult to verify. In Djibouti, there is no requirement to use IFRS, and different SOEs are subject to different accounting standards and disclosure practices. In Egypt, some SOEs adhere to the Egyptian Accounting Standards (EAS), whereas SOEs subject to special laws follow the legacy of the Unified Accounting System. This prevents a true comparison of financial performance with international benchmarks, and even within the country. In practice, unlisted non-financial SOEs do not make their financial statements publicly available. Recent legal changes have strengthened reporting requirements for some SOEs, but disclosure practices for non-listed SOEs remain inadequate. In Morocco, the majority of SOEs prepare

financial statements under Moroccan standards, which seek to approximate the IFRS, but do not fully comply with them. In Tunisia, SOEs are required to apply Tunisian accounting principles, which are not fully aligned with the IFRS. Even where the IFRS are the standard, auditors' opinions are often qualified (negative), thus indicating that the implementation of the IFRS is inadequate (see independent external audit below). Qualified opinions⁴¹ concerning the financial reports of SOEs mean that they are potentially unsuitable for decision making. The IFRS accounting standards are widely considered to be one of the most important contributors to good SOE governance. Therefore, they should play a prominent role in any reform agenda. The IFRS is a good practice for listed and economically significant SOEs. However, it may be too demanding for smaller ones. For these, the "IFRS for small and medium enterprises (SMEs)" may be more suitable, as it is reasonably demanding, but less complex than the full IFRS.

Disclosure of PSOs and their costs

The disclosure of the PSOs of the SOEs and their costs is not generally done. It should be noted that, although the costing and disclosure of PSOs is recommended by the OECD, it is still comparatively rare even in OECD countries. The purpose of PSO costing is to understand what the cost of the public commitments are in order to better track the performance of SOEs in delivering PSOs, as well as in understanding and compensating them for the true costs of such commitments. Explicit accounting for the cost of non-commercial mandates of SOEs would improve the transparency of budgetary processes and potentially improve the targeting of subsidies. A minimum level of disclosure of PSO costs may be expected when SOEs fully apply the IFRS reporting standards. However, SOEs are, arguably, under an obligation to provide a fuller, more detailed insight into the activities they undertake on behalf of the public interest. It is recommended that all SOEs begin

to develop systems that permit an accurate costing of PSOs. This would contribute to a better assessment of their costs and benefits.

Conducting of the independent external audit using International Standards on Auditing (ISA)

The audits of annual financial reports are not uniformly conducted using the International Standards on Auditing, making the annual financial reports of many SOEs unreliable. The information provided in annual financial reports should not be considered reliable unless it is audited by an independent external auditor. Independent external auditors are, in turn, expected to conduct their audits in accord with International Standards on Auditing of the International Auditing and Assurance Standards Board (IAASB). In both Jordan and Oman, International Auditing Standards have been adopted, although the quality of the audits and the timeliness is difficult to verify because most reports are not publicly disclosed. In Egypt, SOEs are required to have an independent audit, but the quality and scope of annual financial reports can be improved. In Morocco, the annual financial reports of most strategic SOEs are audited by firms affiliated with global audit firm networks. The qualified opinions in the audit reports of a majority of SOEs are a key concern. They suggest the need for a more proactive approach in solving the problems that give rise to these qualifications. In the absence of an independent external audit conducted using the IAASB standards, the value of any type of report issued by an enterprise is diminished and is potentially made unreliable. Audit practices, including the governance of the audit and the audit profession, should be reviewed in MENA countries with a view to providing better quality assurances to the users of financial and other reports. Efforts should also be made to follow up on qualified audit opinions to ensure that they do not persist.

⁴¹ The independent external auditor can issue four types of opinions: (1) An unqualified opinion, often called a clean opinion, is the determination that the report is free of any misrepresentation; (2) A qualified opinion is issued when a company's financial records have not been maintained in accordance with the IFRS, but no misrepresentations are identified; (3) An adverse opinion indicates that the financial reports do not conform to the IFRS and, in addition, have been grossly misrepresented; and (4) A disclaimer of opinion occurs when the auditor is unable to complete their audit report due to the absence of reliable financial records.

State audits

In most countries, SOEs are subject to audits and inspections by numerous state bodies, but these should not be considered substitutes for an independent external audit of the SOE's annual financial report.

Despite the great number of inspections and audits that SOEs may be subject to, the OECD Guidelines suggest that the auditing standards and practices of SOEs be the same as for listed companies. The Guidelines also note that a regular annual audit of annual financial reports is needed, similar to those performed in the private sector. In MENA, SOEs may not be obliged to have such an independent audit. State audits generally differ significantly from private audits in that they tend to have more of the character of an "inspection" as opposed to establishing a true and fair view of the financial reports of the enterprise. Furthermore, state inspections are not generally done on an annual basis. Indeed, some SOEs go for years between inspections. The variety of audits to which SOEs are subjected is illustrated by the case of Djibouti. External audits may be conducted by private firms, the General State Inspectorate, the General Inspectorate of Finance, the Court of Auditors, the Directorate of Public Accounting, the Directorate of Portfolio and Audit, as well as sectoral auditors. Additional bodies can demand further information from SOEs, such as statistics bodies or departments for tracking public debt. In some cases, it was reported that multiple institutions were present simultaneously in an SOE. However, on other occasions, SOEs were only checked every five to ten years. MENA countries

would benefit from ensuring that independent audits of the annual financial reports of SOEs are conducted by an independent external auditor in accordance with the relevant professional standard. They should also be overseen by skilled and informed boards of directors that protect the auditor's independence.

Systems for reporting, control, and risk management

Even though SOEs are subject to numerous inspections, there is concern regarding their effectiveness. The control mechanisms to which SOEs are subject are copious, but often complex and bureaucratic. They are focused on form rather than substance. Perhaps somewhat counter-intuitively, the numerous controls to which SOEs are subjected (which generally exceed those of private enterprises) do not appear to result in a reduced incidence of mismanagement, inappropriate risk taking, and/or corruption than in the private sector. Multiple instances and layers of control in the public sector can obfuscate responsibility and reduce accountability. In fact, SOEs are widely considered to be riskier and more vulnerable to control anomalies than their private sector counterparts. Thus, internal control systems are reported to be improving in some MENA countries. In Morocco, the control environment in SOEs appears to have improved significantly over the last 10 years. All strategic SOEs now have systems for internal control and an internal audit function. Throughout the MENA region, a review of the control environment of SOEs could help to improve their operational efficiency, reporting, accountability, and risk management.



Audit committees

Audit committees, which are considered crucial to ensuring a high-quality reporting and control environment for SOEs, are not widely active in the region. Although the OECD Guidelines do not suggest that audit committees be mandatory, they are, nevertheless, widely considered an essential part of good governance. Ideally, audit committees should be staffed fully by independent board members who are considered “financially literate”. In many jurisdictions in the region, there are soft law requirements for audit committees in the relevant corporate governance code. For instance, in Jordan, the code mandates the establishment of both an audit committee and a remuneration committee. In Oman, the requirement for an audit committee is also contained in the relevant code. While these are useful requirements, as noted elsewhere, compliance with governance codes in MENA are not broad based nor publicly reported. As such, it is difficult to know how widespread the use of audit committees is when mandated by corporate governance rules. In Djibouti, no board sub-committees are required under law, except for the banking sector. Audit committees are, however, making inroads into SOEs in some countries. In Morocco, the introduction of mandatory audit committees in SOEs is considered necessary for the establishment and operation of reliable information systems. In 2020, 61 percent of SOEs had established an audit committee, as had 97 percent of commercial SOEs and 49 percent of “public establishments”.⁴² Overall, the establishment

of well-governed, properly staffed, and empowered audit committees can be considered an important step toward better controlling risks and generating better and more reliable information.

Anti-corruption programs

A criticism often levied against SOEs in MENA (as in other jurisdictions) is that SOEs are particularly vulnerable to corrupt practices. Corruption within SOEs may imply a lack of adequate oversight, or possibly misconduct within the public sector at large. The cost of the mistrust in the public sector that can be created through corrupt hiring, procurement and/or sales practices can be significant. Indeed, it can have a wide-ranging impact on the quality of services provided by SOEs, as well as the financial demands that these companies make on the public purse. Interest in the propriety of SOE practices has grown in recent years as part of the general debate concerning public transparency and anti-corruption bodies are becoming more widespread in the region. Their core responsibility consisted of coordinating with the then Governance Minister at the Presidency of Government, providing follow-up of reporting on corruption cases, and ensuring access to information. In general, MENA countries can benefit from strengthening their anti-corruption practices by benchmarking themselves against the newly approved OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises or another relevant standard.⁴³

⁴² DEPP (2021). Authors- insert full reference. Bilan de Gouvernance des EEP au titre de la période 2018-2020, Direction des Entreprises Publiques et de la Privatisation, 2021.

⁴³ OECD. “Guidelines on Anti-corruption and Integrity in State-Owned Enterprises.” (Paris: OECD, 2019). www.oecd.org/corporate/Anti-Corruption-Integrity-Guidelines-for-SOEs.htm



IX. PROCUREMENT POLICIES AND PRACTICES

Procurement

Some MENA countries have reviewed their procurement procedures. However, SOEs remain prone to risks arising from inefficient or insufficiently transparent and structured procurement practices.

There is limited comparative international literature about procurement practices among SOEs, and it is difficult to define a single best approach. However, the essential question that needs to be addressed is what the rationale is for requiring public sector procurement rules to apply to SOEs given that some studies suggest that public sector procurement is inefficient compared to the private sector. The question hinges on whether the additional costs of public procurement rules are justified based on the achievement of the state's goals, as well as the state's special obligation of accountability to the public. Approaches vary internationally from requiring public procurement rules for all SOEs, to providing more flexible rules for SOEs in competition with the private sector, to having no SOE-specific procurement rules at all.⁴⁴

Although formal data is scarce, procurement rules in MENA generally apply to all SOEs, albeit with no formal consideration of the rationale for using public rules or distinctions based on whether or not SOEs compete with the private sector. In this regard, Oman offers a potential way forward. With the consolidation of SOEs under the ownership of the OIA, the OIA has been able to develop a specific procurement framework to apply to all SOEs. The framework seeks to balance the need for government accountability (principally through reporting), while also affording individual SOEs greater flexibility in their commercial procurement.

Nevertheless, there are significant challenges in implementing procurement rules in SOEs. Sometimes, this is because the independence of SOEs can make enforcement of rules difficult. For example, although Jordanian procurement regulations and guidelines are comprehensive, the applicability to majority- and minority-owned SOEs is not clear, nor is the extent to which these requirements are enforced in SOEs. In Djibouti, a legal framework is in place, and laws seek to emulate international good practice. Exemptions to standard procurement rules may occur when a procurement is labelled urgent or when the procurement cannot be done domestically. Other ways of avoiding formal procurement include cutting procurements into smaller bits so that they do not trigger thresholds. The system is often criticized for politicization and clientelism, and numerous high-level scandals have occurred. In Egypt, SOEs are not subject to a standard procurement framework, and the transparency of bids and awards are a concern. Although they control large budgets that involve major procurement activities, each SOE sets its own procurement regulations/bylaws. Also, there is no independent and transparent mechanism to handle complaints. In Morocco, SOEs account for a large share of public procurement. SOEs must abide by public procurement practices which contain a number of exemptions. Some improvement was achieved in reducing payments to suppliers, in part, to ex ante controls. Tunisia has a national public procurement framework that applies to SOEs. It contains exceptions, as in other countries. The public procurement framework was reformed to introduce a comprehensive e-procurement system as of 2019. TUNEPS, the online public procurement system in Tunisia, includes state-owned enterprises. A similar e-procurement portal has been in operation in Morocco since 2014.

⁴⁴ The World Bank Group's recent report *Jobs Undone: Reshaping the Role of Governments toward Markets and Workers in the Middle East and North Africa* (2022), identified a series of preferences in public procurement in eight MENA countries (including Egypt, Jordan, Kuwait, Morocco, Saudi Arabia, Tunisia, the United Arab Emirates, and the West Bank and Gaza). These are related to exclusions and exemptions for SOEs, including an explicit access discrimination in favor of local companies and an explicit requirement for local component



X. SOE POLICIES AND PRACTICES REGARDING CLIMATE CHANGE ACTIONS AND REPORTING

Consideration of ESG issues

As governments, shareholders and the public become increasingly focused on climate risks, there is growing pressure for all companies, including SOEs, to provide comprehensive disclosures concerning climate-related risks and climate change actions.

This trend is explicitly recognized in the OECD SOE Guidelines: Principle V states that SOEs should report on their environmental, social, and governance (ESG) performance in a transparent and comprehensive manner. This principle encourages SOEs to adopt internationally recognized sustainability reporting frameworks and to disclose information about ESG issues that is relevant to their business activities. Overall, the disclosure of ESG performance is still nascent in MENA. Therefore, companies could benefit from guidance regarding how to conduct better ESG disclosures. Given the overriding interest that countries have in climate change and ESG issues, the reporting and management of ESG issues merits further study.

However, throughout the MENA region, ESG is an emerging theme that has not yet been fully integrated into the operations of SOEs or the deliberations of SOE boards. Although improved climate reporting is a useful step, the more fundamental issue is how SOEs and their owner governments will drive climate-related changes in their business operations. This is a critically important issue in the MENA region, where SOEs are involved in many emission-intensive industries (including petro-chemicals, transport, power generation, and manufacturing). Increasingly, the climate change impacts of business operations are becoming significant strategic and fiscal risks, as well as environmental risks. However, sustainability is not yet fully embedded in the strategic planning or risk management frameworks of SOEs. For example, in Djibouti, climate change is not in the forefront. Despite the creation of a ministry in charge of environment and the passage of a number

of environmental laws, climate-related issues have not found their way into SOE boards in a significant manner. In Morocco, an overview of public debt issuers publishing ESG reports shows that, with few exceptions, climate is not yet perceived as a material risk. Similarly, in Tunisia, a recent examination of the last publicly available annual reports of SOEs and state-owned banks did not find any mention of climate-related risks. Not effectively addressing these risks and mainstreaming them into risk management frameworks will increasingly present fundamental challenges to many of the more emission-intensive industries.

Climate change reporting – Which standard?

As an emerging area of reform, there are several key global climate-related reporting standards that aim to improve transparency and consistency in disclosing climate-related risks and opportunities. A summary of the key standards is detailed below. All of these standards aim to provide investors, stakeholders, and the public with reliable and comparable information to support informed decision-making on climate-related issues. Early adopters have often used the Global Reporting Initiative (GRI), and there are examples in MENA of this standard being adopted (box 2). For instance, the Oman Oil Company, OQ, and the Oman Telecommunications Company, Omantel, have voluntarily reported on ESG using the GRI methodology for the last 5 years. For regulators, it is important when choosing a standard that is likely to have a high level of international acceptance. In this context, the World Bank has prepared a Toolkit for Regulators and Shareholders concerning the Management of Climate-Related Disclosures.⁴⁵ When ranked according to their international acceptance, the extent of climate reporting, and the level of government involvement, the Taskforce on Climate-related Financial Disclosure recommendations were selected and adopted as the basis for developing the toolkit.

⁴⁵ World Bank. *Management and Disclosure of Climate Related Financial Impacts for State-Owned Enterprises – A Toolkit for Shareholders and Regulators* (Washington, DC: World Bank, 2021). <https://doi.org/10.1596/37962>

Box 2: Current Frameworks and Standards for Climate-Related Reporting

Global Reporting Initiative (GRI). The GRI Standards focus on the governance, economic, environmental, and social impacts of a company, including its contributions toward sustainable development – whether positive or negative. Users of the GRI Standards identify issues that are of primary importance to their stakeholders. Thus, reports will vary by organization.

Sustainability Accounting Standards Board (SASB). The SASB, established in 2011, focus on reporting to the United States Securities and Exchange Commission. It has taken an industry-based approach based on a 10-sector classification system. The SASB's industry-specific standards identify the subset of sustainability-related risks and opportunities most likely to affect a company's financial condition (for example, its balance sheet), operating performance (for example, its income statement) and/or risk profile (for example, its market valuation and cost of capital). In November 2020, the SASB and IIRC announced their intention to merge and form a Value Reporting Foundation.

Climate Disclosure Standards Board (CDSB). The CDSB is an international consortium of business and environmental non-governmental organizations (NGOs) committed to advancing and aligning the global mainstream corporate reporting model to equate natural capital with financial capital.

International Integrated Reporting Council (IIRC). The IIRC is a global coalition of parties focused on the adoption of integrated thinking and reporting on an international basis. It is used as a means to improve communications about value creation, advance the evolution of corporate reporting, and make a lasting contribution to financial stability and sustainable development. The IIRC primarily positions itself as a global advocate, knowledge generator, and convener.

Task Force on Climate-related Financial Disclosures (TCFD). The TCFD was created by the Financial Stability Board to improve and increase the reporting of climate-related information. The TCFD has issued recommendations for more effective climate disclosures to enable better decision-making about climate-related risks to organizations. The recommendations have now become the gold standard for reporting on climate-related risk. As such, it will allow companies issuing public debt or equity to incorporate climate-related risks in their risk management and strategic planning, including sector-specific guidance.

Using corporate governance codes and listing rules to drive change

Although ESG reporting is now commonplace in the listed companies on the world's largest exchanges, the listed SOEs in MENA are only now beginning to report on climate risks. It is worth noting that climate change is listed among the top 10 priorities of the review of the OECD/G20 Corporate Governance Principles that was launched following public consultations in late 2022. The reasoning is that the disclosure expectations of private and public companies should be equivalent in

order to ensure competitive neutrality. In addition, it is expected that the scope and quality of information provided to the state and the public concerning SOEs should be of at least the same quality as that provided to any normal shareholder of a privately listed company. The World Bank Toolkit on SOE Climate Reporting from 2022 notes that the process of implementing effective and rigorous climate-related disclosures takes time, and that "Regulators should therefore require SOEs to begin the process as soon as possible, recognizing that it may take two to three years before full management integration and disclosure can be achieved. Regulators

should consider a two-year lead time for the first mandatory Climate-Related Financial Disclosure reports. During this time, SOEs should immediately adopt voluntary disclosure of those processes and policies and data that are available.”

It follows that listing rules and/or corporate governance codes can be the long-term mechanism to drive better climate-related disclosures. There are examples that this is already occurring in the region, although compliance is still lagging. Morocco’s Capital Market Authority published guidelines for ESG reporting in 2018 before introducing mandatory ESG reporting in annual financial reports for all companies issuing public debt (as of 2019). Consequently, all listed SOEs report on environmental criteria, as required by the regulator. In addition, the Moroccan Central Bank, Bank Al Maghrib, released a directive in March 2021, which included a financial risk management framework related to climate change

and the environment. It recommended that banks and financial institutions disclose physical, transitional and litigation risks, as well as the environmental impact of their portfolio (according to the Taskforce on Climate-related Financial Disclosure [TCFD] recommendations). However, it is not yet mandatory. The Moroccan *Office Chérifien des Phosphates* (OCP) is the sole company that reports on climate change under the TCFD framework. In Jordan, the Jordan Securities Commission issued instructions on company disclosures in 2019, mandating disclosure obligations for environmental protection and corporate social responsibility for companies listed on the Amman Stock Exchange. Despite this, the Jordan SOE case study prepared as part of this report could not find examples of listed SOEs that specifically disclosed climate risks. Finally, Oman is in the process of developing climate disclosure requirements for listed companies, and it does have some excellent examples (OQ and Omantel) of companies adopting voluntary disclosures.

ANNEX 1: METHODOLOGICAL FRAMEWORK AND APPROACH

The normative and conceptual framework for this report is based on the OECD's 2015 Guidelines for Corporate Governance of State-Owned Enterprises (box 3). It is complemented by the World Bank's Toolkit on Corporate Governance from 2014, as well as its 2019 Integrated SOE Framework (ISOEF). The specific focus areas of the report mirror those of the above-mentioned frameworks. The focus of these frameworks is also reflected in the organization of the report, which is structured along the following dimensions: (i) the legal and regulatory

frameworks for SOEs; (ii) state oversight and ownership arrangements; (iii) performance monitoring; (iv) boards of directors; (v) transparency and disclosure; and (vi) procurement practices of SOEs. In addition, and reflecting developments since the issuance of the OECD 2015 Guidelines, this report also explores the climate change reporting practices of SOEs. This particular focus area is informed by recent conceptual and normative work by the World Bank's SOE Global Solution Group (an internal World Bank network of SOE experts.)

Box 3: OECD Guidelines on Corporate Governance of SOEs

The OECD Guidelines on Corporate Governance of State-Owned Enterprises are recommendations to governments regarding how to ensure that SOEs operate efficiently, transparently and in an accountable manner. First developed in 2005, the guidelines were updated in 2015. They are now widely regarded as capturing the best advice to countries on how to manage their responsibilities toward state-owned enterprises. The main tenets are as follows:

1. The state should disclose the **rationales for state ownership** to the general public, who are the ultimate owners of SOEs. The purpose of state ownership should be to maximize value for society.
2. The **state as an owner** should be professional, transparent, and accountable.
3. SOEs should compete on a **level playing field** with private companies.
4. State ownership and regulatory functions should be separate to avoid conflicting objectives.
5. Minority **shareholders should receive equitable treatment** and have equal access to corporate information.
6. SOEs should respect stakeholders' rights and implement high standards of **responsible business conduct**.
7. SOEs should be subject to the same high standards of **accounting, auditing, and disclosure** as listed companies.
8. SOE **boards of directors** should have the mandate, autonomy, and independence to set enterprise strategy and oversee management, absent of political interference.

Each of these main recommendations are supported by additional guidance and more detailed recommendations.

Source: Adapted from OECD (OECD Guidelines on Corporate Governance of State-Owned Enterprises. (Paris : OECD, 2015). <http://dx.doi.org/10.1787/9789264244160-en>).

Reflecting the normative OECD and World Bank frameworks, there are only a limited number of unambiguous and quantifiable benchmarks for SOE governance. Consequently, the analytical approach of the reports is, to a large extent, qualitative and context specific.

The report also leverages methodological and practical experiences from similar studies in other regions. The structure of and practical execution of the report has benefited from experiences with similar World Bank regional studies in Latin America and the Caribbean (LAC)

(2012), South Asia (2015) and Europe and Central Asia (ECA) (2020), as well as related studies of MENA by the OECD (2013) and the World Bank (2015).

Data collection is primarily based on desk research and expert interviews. The scope of inquiry under each of the above-mentioned governance dimensions was based on the Integrated SOE Framework corporate governance guideline and questionnaires. The project used the ISOEF's Corporate Governance Questionnaire as a framework for data collection by local teams and consultants.

IMAGE REFERENCES

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