The Economic and Social Impact of Privatisation of State-owned Enterprises in Africa

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Mike I. Obadan

Green Book

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Avenue Cheikh Anta Diop Angle Canal IV, BP 3304 Dakar, 18524 Senegal
www.codesria.org

Layout by Daouda Thiam

Cover designed by Ibrahima Fofana

Printed by Imprimerie Saint Paul, Dakar, Senegal

Distributed in Africa by CODESRIA

Distributed elsewhere by the African Books Collective
www.africanbookscollective.com

CODESRIA Green Book Series
ISBN: 978-2-86978-228-0

CODESRIA would like to express its gratitude to African Governments, the Swedish Development Co-operation Agency (SIDA/SAREC), the International Development Research Centre (IDRC), OXFAM GB/I, the MacArthur Foundation, the Carnegie Corporation, the Norwegian Ministry of Foreign Affairs, the Danish Agency for International Development (DANIDA), the French Ministry of Cooperation, the Ford Foundation, the United Nations Development Programme (UNDP), the Rockefeller Foundation, the Prince Claus Fund and the Government of Senegal for supporting its research, publication and training activities.

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Acknowledgement

I am most delighted to express my very sincere appreciation to the Executive Secretary of CODESRIA, Professor Adebayo Olukoshi, for giving me the opportunity to carry out this study in Dakar. I will always cherish the highly enabling environment coupled with the support from all the staff that I came across in the various departments. In particular, I whole-heartedly thank the Deputy Executive Secretary, Professor Jean-Bernard Ouedraogo, Director of Research, Dr Ebrima Sall, Director of Administration and Finance, Ms Takayi Chibanda, Head of Publications, Dr Francis B. Nyamnjoh, and the Library staff, especially Mr Jean Pierre Diouf.

I also appreciate the useful comments on the first draft of this paper by two anonymous reviewers, while I take responsibility for any remaining errors.

Preface

As an economic policy instrument, privatisation of state-owned enterprises (SOEs) began to gain popularity in both developed and developing countries after the apparently successful privatisation experiments of the British conservative government in the late 1970s. However, in the 1980s, privatisation became an integral element of the policy package, which was later christened the "Washington Consensus" model of economic development. This model is predicated on the deregulation and liberalisation of economic activities and minimal role for the state. Since the late 1980s, privatisation, as a major instrument of economic reform, has been stepped up in almost all African countries. But then, after one and a half decades of vigorous implementation of privatisation programmes in Africa, the need has arisen for a comprehensive and systematic analysis of the various privatisation issues, particularly the economic and social impact in relation to the numerous claims made on its behalf.

So far, empirical knowledge of privatisation in Africa is very limited and, in the wider literature, empirical findings on privatisation with respect to the rest of the world are far from conclusive. Privatisation does not appear to be a panacea that works in all circumstances in all branches of industry. Thus, in the light of the clear need for a comprehensive and rigorous analysis of privatisation in Africa, this study undertakes a state-of-the-art review of privatisation issues as a prelude to an in-depth study of the economic and social impact of privatisation. It is essentially a preliminary survey of privatisation issues and research questions to stimulate further research.

Mike I. Obadan

August, 2008

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Chapter 1

Introduction

Privatisation, as an economic policy instrument, began to gain popularity in both developed and developing countries following the apparent successful results of the rather ambitious programme of privatisation embarked upon by the conservative government, led by Mrs Margaret Thatcher, in the United Kingdom in the late 1970s. Indeed, privatisation programmes began to replace the big and rapid expansion in state ownership and public sector activities of the 1960s and 1970s. During these periods, international policy tended to favour state planning and state ownership to lever investment and capital accumulation as necessary ingredients for economic development. But since the early 1980s, sentiments have changed in the international financial institutions and donor agencies, and a number of governments, in the face of changing development paradigms and mounting evidence of poor performances of state-owned enterprises (SOEs) or public enterprises (PEs), resulting in huge burdens on the government budgets, made widespread attempts to curtail the economic role of the state through privatisation, among others (Walle 1989). Privatisation, in the 1980s was an integral and very vital element of the policy package which was later christened the 'Washington Consensus' model of development which stresses market forces, deregulation, trade and financial liberalisation, smaller role for government and macroeconomic stability, among others (Williamson 2000 and 2003).

Privatisation emerged as a major issue for policy discussion in the second half of the 1970s due to the convergence of a number of factors (Cook and Kirkpatrick 1988). First is the election of governments in a number of developed countries, most notably United Kingdom and United States, that were ideologically committed to greater use of the market in securing economic objectives. The rise of particularly aggressive right-wing governments, such as those attracted to Thatcherism and Reaganism, coincided with a more general shift in the balance between market and state as neoliberal perspectives gained

ground at the expense of Keynesian welfarism and state-led modernisation (Fine 2005: 2). Secondly, at the same time, the structural obstacles encountered by the industrial countries in achieving full employment and satisfactory economic growth were exacerbated during the 1970s, as these economies experienced difficulties in adjusting to large shifts in relative prices induced by the oil price hikes beginning from 1973-74. Deregulation and increased market competition were seen as the means of accelerating the process of structural adjustment. Thirdly, the impact of globalisation and new technologies had been such that the resultant volume and range of financial services made available gave rise to a wealth of "idle capitals" that made itself busy in pursuit of privatisation. Finally, subsidisation of poorly performing SOEs was also perceived as a constraint upon the process of industrial restructuring. Privatisation in various forms was thus seen as panacea. The appeal of privatisation reflected both the ideological desire for smaller government and a belief in the superior economic performance of the private sector.

The UK privatisation, which served as an inspiration and model to many other countries, began with policy analysis by the Conservative opposition party in the 1970s. Reducing the power of the public-sector trade unions was an important objective. But in the early years of the Conservative Government, following the 1979 elections (1979-February 1982) trade-union influence was not an issue, and some public-sector assets were sold, most of them being small (Bishop and Kay 1989). But thereafter, privatisation grew into a central component of the government's political programme with the privatisation of the British Telecommunications in 1984, with 51 percent of the shares sold at 3.9 billion British pounds sterling. Following this experience, privatisation spread to the developing countries; at first slowly, but increased sharply in the second half of the 1980s, under the impetus and strong support of the international donor community, coupled with the need to cut government expenditure in the face of fiscal crises, and an intellectual and ideological climate increasingly hostile to state intervention in the economy (Walle 1989). In this direction, Lesser (1991) stresses that the increased reliance on market forces in the developing countries became one of the clarion calls of development in the 1980s. It is a call sounded by many of the bilateral donor agencies, the World Bank and the IMF. In some cases, it is a policy, which has been imposed on developing countries as part of the price for IMF, donor and creditor support. This view is also shared by Commander and Killick (1988) who observe that 'the privatisation movement is symptomatic of a value shift among the electorates and governments of many major Western countries which has been exported to the developing countries, both as a general spread of ideas and specifically through the policy conditions

attached to multilateral and bilateral assistance. It is a value shift which places less emphasis on distributional concerns.' Indeed, the privatisation and commercialisation programmes imposed from outside by agencies such as the World Bank and IMF, or by national governments to serve ruling elites have tended to result in a massive concentration of wealth and are transforming power to remote bodies beyond the reach of political accountability (Martin 1993:1).

Even though the philosophy of privatisation has been embraced to the point where the perceived superiority of the private sector in the provision of goods and services has become almost axiomatic (Adam, *et al* 1992), the concern and caution that have been expressed about the ideological crusade for private enterprise, more especially as a blanket condemnation of public sector intervention is inappropriate. Stiglitz (1999), for example, notes that 'some PEs have operated at a level of efficiency comparable to, or greater than, that of similarly situated private enterprises. Typically, these PEs are associated with firms subjected to competition, either in exports (as in Korea's steel industry) or domestically (as in Canada's rail roads) as described in Caves and Christensen, 1980.' Thus, it is felt that privatisation needs to be considered in relation to specific sectors, and not as a blanket panacea (Heald 1990; Obadan 2000). And that the proper approach to discussing the future of the public sectors in particular countries is to adopt a tough and questioning attitude towards the performance of existing public sector organisations (why do they exist, what are they achieving, how might they be improved, should they be improved, should they be abolished?), whilst rejecting the views of those who wish to export privatisation as their contribution to international trade (Heald 1990:4).

This obviously implies the need to avoid unnecessary and inappropriate privatisation and, perhaps, as has been stressed, the need for privatisation to be implemented on a pragmatic, enterprise-by-enterprise basis rather than be propelled by ideological considerations (Obadan 2000: viii). But where an unqualified case for privatisation is made in the sense that 'public sector is bad and private sector is good,' then it is almost impossible to generate a debate which acknowledges that different sectors may raise different issues of economic organisation and of salience to objective analysis. It is also further impossible for the ideologists of privatisation to appreciate that when government fails the market may not do better, especially in developing countries where the markets (products, labour, financial and capital) are still weak, underdeveloped and characterised by gross imperfections (World Bank 1995; Obadan 2003).

Nevertheless, pro-privatisation advocates have sounded triumphant. The President of Adam Smith Institute in London, Madsen Pirie, is reported to have asserted, in a speech at the Institute's Fifth International Conference on Privati-

sation and Commercialisation, that 'privatisation has proved itself capable of reviving every country. It will continue its long march through the public sectors of the world. Privatisation is finite — you have to stop when everything is gone' (Martin 1993:50). And in 1999, one of the World Bank advocates of privatisation, Nellis (1999:1), wrote as follows:

> Privatisation appears to have swept the field and won the day. More than 100 countries, on every continent, have privatised some or most of infrastructure, manufacturing and services. Including the very large number of firms privatised in Central and Eastern Europe (CEE) and the former Soviet Union (FSU), an estimated 75,000 medium and large-sized firms have been divested around the world, along with hundreds of thousands of small business units. Total generated proceeds are estimated at more than US$735 billion. Every country, including India, Russia, China, Vietnam, Cambodia and Laos, that still retains a significant number of publicly-owned firms, is privatising some or most of them (save for Cuba and Democratic People's Republic of Korea). One crude but telling measure is that the process has not been reversed.

Shirely and Wash (2000), after examining 52 studies that empirically assess the effects of privatisation in sub-periods within the 1971-99 period, report that 32 of them find the performance of private and privatised firms to be superior; 15 find that there is no significant relationship between ownership and performance or that the relationship is ambiguous and 5 conclude that publicly owned firms perform better than private firms. Yet, they conclude that 'none of the studies finds that performance would be better had they not been privatised.'

And we are further informed that Meggison and Netter (2001) in their extensive survey of empirical records on financial and operating results of privatisations around the world, found conclusive evidence that privately-owned firms outperform SOEs in operating and financial indicators. But we are not told of the distributional and social consequences of the privatisations. In any case, are the claims for privatisation not overstated? As Stiglitz (2000) has observed:

> Advocates of privatisation point with pride to the large fraction of state enterprises that were turned over to private hands. These privatisations were dubious achievements, however. Afterall, it is easy to simply give away state assets, especially to one's friends and cronies. The incentives for doing so are especially strong if politicians conducting the privatisation can obtain kickbacks, either directly or indirectly, as campaign contributions. Indeed, if privatisation is conducted in ways that are widely viewed as illegitimate and in an environment that lacks the necessary

> institutional infrastructure, the longer-run prospects of creating a market economy may actually be undermined.

Privatisation, as a major instrument of economic reform, has been stepped up significantly in almost all African countries since the late 1980s. This has been done against the background of shifting ideologies, donor pressure and uninspiring performance of PEs with the resulting public dissatisfaction. Currently, there is hardly any African country that does not have some kind of privatisation programme in place. The United Nations Economic Commission for Africa (UN-ECA) (2003) has observed that, as part of efforts to deepen economic reforms and increase private-sector involvement in economic activities in Africa, many countries have developed privatisation schemes to increase private investment in key public enterprises. The tempo of privatisation heightened in Sub-Saharan Africa (SSA) in the 1990s with the total number of transactions rising from 200 in 1990 to 3,486 in 2002 (World Bank 2004: 261). But then, a number of pertinent issues and claims on privatisation have yet to be comprehensively explored with respect to SSA.

This paper undertakes a state-of-the-art review of privatisation issues as a prelude to an in-depth study of the economic and social impact of privatisation in Africa. The objective is to provide insights into the many issues that have underlined the privatisation debates: performance of SOEs in relation to private enterprises, arguments for privatisation, the macroeconomic, microeconomic and social impact of privatisation, among others. Accordingly, the paper is organised as follows: Section 2 discusses SOEs whose perceived poor performance has provided ammunition for the advocates of privatisation. Section 3 examines the theoretical arguments and ideological basis of privatisation while Sections 4, 5 and 6 discuss the concept, objectives, principles and methods of privatisation, respectively. Section 7 briefly reviews the current state of privatisation in Africa. The theoretical and empirical analyses of the impact of privatisation are reviewed in Sections 8 and 9, respectively. Section 10 concludes with a summary of research issues/questions, which are identified in the various sections of the paper.

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Chapter 2

State-Owned Enterprises and the Privatisation

Debate

As has been rightly observed, the public-enterprise sector lies at the heart of the privatisation debate (Cook and Kirkpatrick 1992: 5). Attention has been focused on the sector, perhaps fairly or unfairly, in terms of its rationale, objectives, economic performance and contribution to the development process, particularly in the developing countries.

Sizes and Significance of the SOEs' Sector

Nellis and Kikeri (1989: 659) report that worldwide, at the beginning of the 1980s, PEs were estimated to have accounted for an average of 10 per cent of GDP at factor cost. PEs have been important in industrialised as well as centrally planned economies, accounting for significant proportions of GDP, employment and gross fixed capital formation. Developing countries are considered as typically having relied more on SOEs than industrial countries did in a bid to achieve economic and social objectives (Kikeri, Nellis and Shirely 1994: 242). And the PE sector in SSA is proportionately larger than in other developing areas (Fontaine 1991: 4).

The average contribution of PEs to GDP in developing countries rose from 7 per cent at the beginning of the 1970s to about 10 per cent at the end of the decade (World Bank 1983). Between the countries are considerable variations, ranging from 3 per cent in Paraguay and Nepal to 38 per cent in Ghana and Zambia. And in most developing countries, the share of public enterprise investment in total gross fixed capital formation exceeds 25 per cent (Todaro 1989: 561) and, in some cases, accounts for more than 60 per cent of total investment (Cook and Kirkpatrick 1988: 5). By the early 1980s, PEs were reported to have accounted, on the average, for 17 per cent of GDP in Sub-Saharan Africa (in a thirteen-country

sample), 12 per cent in Latin America, and much more modest 3 per cent in Asia (excluding China, India and Myanmar), compared with 10 per cent of GDP in mixed economies worldwide (Short 1984 in Kikeri, Nellis and Shirley 1994).

In addition to their traditionally dominant presence in utilities (gas, electricity, and water), transportation (rail roads, airlines and buses) and communications (telephone, telegraph and postal services), SOEs have become active in such key sectors as large-scale manufacturing, construction, finance, services, natural resources, and agriculture (Todaro 1989: 567).

In Sub-Saharan Africa, Fontaine (1991) reports that the structure of the PE sector evolved as the share of public investment increased. The sector was initially developed in agriculture, infrastructure and public utilities. But it was extended to manufacturing during the 1970s, either following abrupt shifts in policy induced by a mixture of nationalisation and a rise in public investment, or more gradually. The extension of the public sector to manufacturing and industry was in line with the industrialisation strategy of deepening import-substitution. But despite the increase in manufacturing investment since the 1960s, it remains limited and public intervention continues to be concentrated in public utilities and transport, and mining (Fontaine 1991). This tends to confirm the traditional view that, considering market failure and public goods arguments, public sector intervention should be confined to infrastructure and utilities. If this is the case, then one wonders at the basis of the various contentions that the public sector has become too large in many developing countries and over-extended in Africa. On this, the World Bank's 1981 Report on economic prospects in Sub-Saharan Africa (the 'Berg Report') concludes that:

> It is widely evident that the public sector is over-extended, given the present scarcities of financial resources, skilled manpower and organisational capacity. This has resulted in slower growth than might have been achieved with available resources, and accounts for the present crisis' (World Bank 1981).

And Kikeri, Nellis and Shirley (1994) believe that 'the problem is not simply that SOEs have yielded disappointing rates of return on the capital invested in them. Overextended and poorly performing SOEs have slowed growth of the private sector in many developing countries.'

Writing along the same lines, Alexander (1992) states that 'one of the most striking features of economies of Africa, in contrast to many Asian economies, for example, is the dependence of governments on parastatal organisations to execute development plans as well as to provide goods and services for the general populace. The proliferation of PEs in the industrial and service sectors

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as well as the basic public services — water, electricity, telecommunication, transport, etc. — has resulted in governments being over extended financially and managerially.'

The implication of the above assertions is that the size of the public sector in SSA is too large and should therefore be rolled back through privatisation. But is there empirical evidence to support the alleged negative effect of the size of the public sector? As Kirkpatrick (1989) has observed, although it is frequently made, the argument that the public sector in developing countries is 'over-extended' and requires 'rolling back', as a general proposition, is empirically unproven. Evidence to support the hypothesis of an inverse relationship between macroeconomic performance and size of the public sector is lacking. In a cross-country study, Nunnenkamp (1986) was unable to detect any statistically significant relationship between the relative importance of the PE sector in developing countries (as measured by their output and investment shares) and variations in GDP and gross fixed capital formation, the level of industrialisation and the growth in employment. And for a sample of 23 developing countries, Kirkpatrick (1986) finds a negative but statistically insignificant correlation between the share of public enterprise in GDP and growth in income in the 1970s. Thus, the size of the public sector per se does not have a significant bearing on the performance of the sector or the economy. What matters is the effectiveness with which resources allocated to the public sector are utilised (Kirkpatrick 1989: 94). And to Adam, *et al* (1992), the growth of the SOE sector needs not be viewed as a problem, more especially as ownership, whether public or private, in their evaluation, is not the key determinant of enterprise performance and efficiency of resource allocation. Thus, an interesting issue to investigate empirically, in the context of SSA, is the relationship between public and private sector sizes and economic performance.

The Rationale for Public Enterprises

At various times, since World War II, most countries, particularly developing countries, have attempted to use PEs to achieve their economic and social objectives (Obadan 2000: 4). The public sector has been seen as a major contributor to economic growth and social political stability (Hemming and Mansoor 1988: 31). Fontaine (1993) states that PEs were created in Africa for much the same reasons as in most countries — to correct market failures, provide public goods, control natural monopoly and seize the "commanding heights" of the economy. The paucity of African entrepreneurship and of local private investment capital, combined with the infant industry argument, reinforced the need for the state to

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promote development through the establishment of specific agencies. According to Vermon-Wortzel and Wortzel (1989), developing countries turned to state ownership of certain enterprises for reasons that were primarily pragmatic, rather than ideological; they created SOEs to provide goods and services or to serve social goals that the private sector appeared unwilling or incapable of addressing. Country governments used SOEs as instruments of social or industrial policy. They created SOEs to provide specific goods or services at a particular level to the populace. In some countries, SOEs came into being to bail out failed private-sector firms. Vernon (1984) writes in the same vein, that some governments formed SOEs to address socio-political objectives such as promoting industrialisation, creating jobs, defending national interests, reducing regional differences and saving declining firms or industries. But Nellis and Kikeri (1989) observe that market failure arguments justifying government interventions in the developed countries were applied in the developing countries — natural monopolies, externalities and merit goods — and that more practically, developing countries inherited from the colonial powers, at independence, public sectors reflecting heavy economic intrusion and government intervention. But that they added to the sector on ideological and pragmatic grounds, for example, as a result of the absence of local private sector or because it was too small and insufficiently developed, therefore having limited access to capital and being technologically underdeveloped.

In general, however, economic theory recognises public ownership as a response to the failure of private markets to secure efficient and equitable outcomes, as well as a host of economic and social objectives. Therefore, in the context of a variety of economic, social and political objectives, the rationale for public ownership can be summarised as follows (see for example, Obadan 2000; Hemming and Mansoor 1988; Todaro 1989; Paul 1985; Walle 1989; Bienen and Waterbury 1989; Vernon-Wortzel and Wortzel 1989; Bouin and Michalet 1991; Dijk 1994):

- Countering of monopoly powers in many sectors and the need to ensure that prices are not set above the costs of producing the output;

- Freedom of government to pursue equity objectives: redistribution of income, job creation, regional development, and access to essential goods and services at affordable price;

- Capital formation, infrastructure development and other 'lumpy' investment (e.g., steel, petrochemicals);

- Lack of private incentives to engage in promising economic activities and, hence, filling in for a deficient private sector;
- Taking over failed private enterprises;
- Presence of external costs and benefits and need to produce goods that have high social benefits, but which the private sector has no incentives to produce;
- Ideological motivations as well as a host of other reasons, such as the desire of some governments to strengthen economic sovereignty and gain national control over strategic sectors, or over foreign enterprises (multinational corporation) whose interests may not coincide with those of the country, or over key sectors for planning purposes.

Although not often expressly stated, some analysts, Walle (1989) for example, believe that in political terms, PEs constituted important resources for state elites to be developed and harnessed in the form of potential rents, jobs and the servicing of constituencies. Patronage and technocratic considerations combined to make public production a popular policy outcome. And Dijk and Nordholt (1994:11) claim that 'It often turns out that established interests of particular groups, which are directly or indirectly connected to the government, such as civil servants and the military, trade unions and entrepreneurs operating within SOEs or politically powerful families, actually motivate the raison d'être and continuation of SOEs'. They serve as powerful instruments in the creation of political alliances. Many public enterprises were thus faced with multiple and sometimes conflicting objectives (Bouin and Michalet 1991; Dijk 1994; Vernon 1984, etc.). Even though some PEs were expected to generate surpluses with which the government could finance investment in priority sectors, improving market efficiency was not a major preoccupation (Walle 1989). A good number of PEs are preoccupied with the accomplishment of social and political objectives. These points are important to note in the evaluation of the performance of PEs, particularly as social and political objectives are largely incompatible with maximum economic efficiency or efficient delivery of required goods and services. Most developing countries tended to be concerned with increasing social welfare.

Performance of Public Enterprises

SOEs have been most denounced and vilified in the area of economic performance. Volumes of literature have been produced, expressing condemnation of the poor performances of PEs (see, for example, Nellis and Kikeri, *et al* 1994;

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Killick 1983; Walle 1989; Shirely 1983; Vernon-Wortzel and Wortzel 1989; Alexander 1992; Dijk and Nordholt 1994; Kickpatrick 1992, etc.). The point has been vehemently made that SOEs have not lived up to the expectations of their creators and funders, and that in country after country, unbridled state expansion has led to the following (Paul 1985: 42; Samuel 1999: 13):

- economic inefficiency in the production of goods and services by the public sector, with large costs of production, inability to innovate and costly delays in delivery of the goods produced;
- ineffectiveness in the provision of goods and services, such as failure to meet intended objectives and diversion of benefits to elite groups;
- rapid expansion of the bureaucracy, severely straining the public budget with huge deficits of PEs becoming massive drains on government resources, as well as resulting in inefficiency in government; and
- poor financial performance of PEs, reflecting a history of huge financial losses, overstaffing and burden of excessive debts.

Thus, PEs in many developing countries have been attacked for being economically inefficient, wasteful of resources, making significant demands on government resources as well as on domestic and foreign credit, operating on deficits and failing to show profits. Apart from being an unsustainable burden on the budget and the banking system and yielding disappointing rates of return, poorly performing SOEs have also been criticised for slowing the growth of the private sector in many developing countries through a number of channels (Kikeri, *et al* 1994): governments often block the entry of private firms that would compete with SOEs; government credit directed to capital intensive SOEs often crowds private firms out of credit markets; perception of implicit government guarantees for credit to SOEs affect bank lending to the disadvantage of the private sector; and inefficient provision of critical inputs by badly managed public utilities has increased the costs of business to private firms and limited the potential for expansion.

In Africa, the poor performance of the PEs attracted a great deal of criticisms, particularly in the 1980s, as the macroeconomic environment, arising from the impacts of the global economic crisis, became less accommodating to the resulting inefficiency in resource allocation. Nellis (1986) returned an unfavourable verdict on PEs in SSA as follows:

> PE earnings are generally low; many run at losses; often these losses are of a large magnitude. Far from contributing to government revenues,

> African PEs have regularly become a heavy burden on already strained budgets. Few PEs generate revenues sufficient to cover operating costs, depreciation and financial charges; a good percentage do not cover operating costs alone. In many instances where PEs are classified as profitable, closer examination reveals distorted prices, direct subsidies, hidden transfers, preferential interest rates and a host of other elements which — if properly accounted for — would reduce the paper profits of the PE in question. The conclusion is that African PEs present a depressing picture of inefficiency, losses, budgetary burdens, poor products and services, and minimal accomplishment of the non-commercial objectives so frequently used to excuse their poor performance. On the whole, PE sectors are not fulfilling the goals set for them by African planners and leaders.

Fontaine (1991), in a similar vein, concludes that PEs in Africa are by and large inefficient, with high production costs, low productivity and less productive use of resources in the PE sector than elsewhere in the economy. Also, in making a case against SOEs and, hence, for privatisation, an anonymous reviewer has stressed that the economic system within which SOEs were established (during 1960s and 1970s) was, in many African countries, stagnating or collapsing by the 1980s, and the status quo was simply not sustainable. To him, SOEs were part of a system that was impoverishing African populations and simply could not go on and had to change.

However, the critics of PEs also grudgingly admit that some PEs performed well and still perform well. According to Nellis and Kikeri (1989), many PEs in many countries are making money and not all PEs, even in a region as difficult as Africa, are loss makers. But they quickly add the caveat that the good performers are the exceptions. And that some PEs which are making money would not be, were they not protected at the expense of the society as a whole. But they are unable to admit that a good number of the private firms that are making profits in the developing countries do so under strong government protection and patronage.

Even then, it appears that the evaluation of financial performance and profitability is often biased against PEs. As Commander and Killick (1988) rightly observe, the discussion of privatisation and microeconomic efficiency is almost invariably conducted in terms of market valuations, but this seriously biases the debate against PEs, whose pricing and production policies may be based by government upon social valuations, for example, economic or shadow prices. Besides, the critical assessments of PEs also fail to take cognisance of the numerous failures of private firms and, indeed, that public enterprises were often created to fill vacuums left by private enterprise. More importantly, the

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assessments of SOEs have tended to be based solely on financial performance without taking account of the important non-financial objectives pursued by such enterprises. It is the fact that SOEs are expected to pursue both commercial and social goals that make them different from private firms. Obviously, in the course of meeting the social objectives, profitability may reduce. On the other hand, the single-minded pursuit of private firms is profit and they can change their product or service line in order to achieve the profit objective. And as Vernon-Wortzel and Wortzel (1989) correctly observe, private sector firms see means and ends differently from SOEs. Private firms do not focus directly on a particularly defined level of goods and services. Often, their objectives are financial. They aim to earn profits. In the private sector, an enterprise meets its objectives by offering a product or service; but offering that product or service is not its objective. An aggressive private-sector firm will change its product or service offerings as quickly as possible to better meet its objectives. So, for different reasons, the private-sector firm may not provide the product or service package the government had in mind when it created specific SOEs. And where empirical research compares profit-based performance indicators, which is often the case, the public sector is being judged by the criterion of the private sector. Thus, efficiency can only be fairly assessed relative to the goals being pursued, and much of the perceived "inefficiency" of PEs results from judging them by criteria which only partially corresponds to their policy objectives.

The World Bank, in its World Development Report 1986, admits that 'it is impossible to judge the performance of parastatals objectively when they are frequently caught in the cross-currents of mutually government contradictory objectives.' The point, however, is that many SOEs have addressed their economic purposes, and a substantial number have even managed to satisfy the needs of the people for whom they were created. But some other analysts believe the contrary to be the case. Bouin and Michalet (1991) state that PEs seem to have failed to fulfil the social function relating to the interests of the community and social welfare satisfactorily, especially as regards the most underprivileged social classes. Kirkpatrick (1992) observes that empirical evidence appears to support the view that PEs have failed to realise their distributional goals and, in some circumstances, have produced perverse results. Thus, with the negative verdicts on the fulfillment of PEs' economic, financial and social goals, the stage was obviously set for the privatisation advocates to state their case within the framework of an ideological crusade.

Chapter 3

The Case for Privatisation

The case for privatisation has been forcefully made by its advocates against the background of the much-advertised poor performances of SOEs and theoretical arguments relating to the perceived superiority of private production over public production or efficiency of private firms over public enterprises. The previous section examined the SOEs performance argument. This section concentrates on the theoretical arguments and the ideological foundation of privatisation.

The Theoretical Arguments

The growing concern with the alleged or apparent inefficiencies in the public-enterprise sector's performance and the more general shift in the dominant development paradigm towards neoliberal economic orthodoxy, have been propelling factors in the current privatisation. Privatisation was placed on the political and, hence, economic and economics agenda, in the early 1980s by the meteoric rise of neoliberalism (Fine 2005: 2). Indeed, Martin (1993) observes that:

> the diverse weaknesses displayed to one degree or another by public sectors in most countries provided plenty of ammunition for the New Rights' offensive, while the failure of the 'communist' system to deliver efficiency, equity or democracy sustained the Right's claim that free markets and free people are indivisible. But although privatisation and commercializaton were justified in those terms, on the whole, they have been designed to meet the needs of transnational business in a fast globalising market.

And the perception that development planning has 'failed' led to a shift in the dominant paradigm towards a neoclassical market-oriented view of development process and policy (Cook and Kirkpatrick 1988: 8). At the heart of the neoliberal ideology is the hostility to the view that society should organise the provision of services and structure, and regulate the economy. To the advocates, the market

and private sector would create wealth, which would trickle down to all. And competition between producers to please consumers would define the public interest and ensure it is well served. The broadly shared outlook is that the free market knows best and the private sector does best, and that the state's main task in economic and social development is to minimise impediments and maximise inducements to private capital accumulation (Martin 1993: 6). In the context of the privatisation debate, the neoclassical analysis translates into policy prescriptions directed towards a reduction in the size of the public sector, the removal of government controls, the fostering of competition, and a greater reliance on the market and price mechanism for the allocation of resources (Cook and Kirkpatrick 1988: 9). Thus, it is argued that, since many PEs are making losses and are inefficient, they should be transferred to the private sector where the allocative efficiency of the investment will improve and the enterprises will be profit-making (Ramanadham 1992: 11).

Essentially, the case for privatisation has been hinged on the neoclassical hypothesis that private ownership, compared to public ownership, brings greater efficiency and rapid economic growth (Hemming and Mansoor 1988; Nellis and Kikeri 1989; Todaro 1989). Of course, there have also been other pragmatic considerations relating to PEs' performance and the implications for public finance. In this direction, Bienen and Waterbury (1989: 618) argue that privatisation in most developing countries is, in part, a response to the need for fiscal austerity and is designed to reduce deficits generated by PEs, while Walle (1989: 604) believes that fiscal gains from privatisation have probably weighed most heavily on developing country governments trying to balance public accounts. But the roles of ideology and the alleged superiority of private over public production, in the sphere of efficiency, have been central. Private ownership is often seen as the best means of enforcing market discipline and promoting efficient allocation and use of resources. Economic efficiency is viewed in terms of productive efficiency and allocative efficiency (Adam et al, 1992; Walle 1989: 604 and Martin 1993: 48). Productive efficiency requires that whatever is done should be achieved at minimum cost. In the context of privatisation, gains in productive efficiency can arise from a more optimal use of inputs within the enterprise and the resultant lower cost of production. Allocative efficiency, on the other hand, implies that what is done meets consumer needs at prices which reflect the costs of provision. In a privatised firm, gains in allocative efficiency can result if the reform can force down consumer prices so that the results are closer to the marginal cost of production. The encouragement to achieve efficiency may come from the product market or capital market or both. The product market may be

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the one in which consumers can transfer their demands to other firms; the capital market can impose the threat of bankruptcy or takeover (views of Kay and Thompson as reflected in Martin 1993: 48).

The standard neoclassical position, derived from the theory of perfect competition, argues that the market mechanism tends to the direction of producing a Pareto-optimal result, where resources are so distributed between alternative uses that there are no changes that could be made that would not make someone worse-off. In other words, neoclassical economic theory associates official outcomes with market structures in general, and with the extent of competition in particular, and not ownership. Competition, it is argued, generates an efficient allocation of resources, reduces managerial slack, and stimulates managerial and worker efforts, leads to cost-reducing investments or quality-improving expenditures (Konings 1997). Thus, the basic difficulty with the argument of divestiture, on grounds of an alleged superior allocative efficiency, is that while mainstream microeconomic theory does point in the direction of the allocative superiority of competition, it is silent on the ownership issue (Commander and Killick 1988: 102). Indeed, there is no necessary connection between the two -- private ownership and competition. And the World Bank (1983: 50) admits this much when it states that 'the factor determining the efficiency of an enterprise is not whether it is publicly or privately owned, but how it is managed. In theory, it is possible to create the kinds of incentives that will maximise efficiency under any type of ownership.' Nevertheless, Stiglitz (2000), in corroborating the importance of competition in efficiency outcomes, asked if policymakers should go ahead with privatisation if they cannot have competition to go along with it.

Despite the lack of a direct causal link in neoclassical theory between private ownership and efficiency, related economic theories take a more positive view of the connections between ownership and efficiency (Nellis and Kikeri 1989; Commander and Killick 1988). These theories which derive from the property rights and public choice schools identify factors accounting for poor PE performance and posit that private owners would avoid or evade the noted constraints. The property rights theory is principally concerned with the relationships among ownership rights, incentives and economic efficiency. Furubotn and Pejovich (1972) have a survey of the literature while Hanke (1986) has an application to privatisation. The theory deviates from mainstream theory by rejecting the firm as a unit of analysis and profit maximisation as the guiding behavioural postulate; and focuses, instead, on the actions of managers within a firm who are presumed to pursue their own self-interests. According to the property rights

theory, various forms of ownership give rise to different economic incentives and therefore, different economic performance. Private-sector organisations, where rights to profits are clearly defined, will perform better than public-sector organisations, where rights are diffused and uncertain (Alchian 1965; De Allessi 1969). It is also stressed that positive incentives to perform efficiently are inherent in private ownership. Private owners have stronger incentives than government appointees to maximise profits because they own equity and so bear the financial consequences of their decisions. They are residual claimants who benefit directly from efficiency and hence have greater incentives to monitor managers. But under public ownership, since no one has a clear claim over the residual assets of an SOE, there will be no market for corporate control and, hence, no threat of take-over to discipline managers who are not maximising profits (Vickers and Yarrow 1988). Private firms, it is further argued, are also more capable and willing to implement high-powered incentives to motivate managers (Alchian and Demstez 1972; Grossman and Hart 1986). The issue of SOEs' inability to monitor managers unlike private enterprises is also espoused by agency theory (Macdonald, 1984).

"Agency problem", from industrial organisation theory, suggests that the divorce of ownership and arrangements between a principal and the agent creates problems for the principal (government) to monitor the agent (manager) due to asymmetry of information. Asymmetric information leads to a moral hazard problem since the agent may use the principal's ignorance as an excuse to supply sub-optimal level of efforts. The poor incentives for efficiency derives partly from the inability of the state to monitor and exercise effective control over the discretionary behaviour of enterprise managers whose incentives for efficiency are low-powered, and partly from political interference which distorts the objectives and constraints faced by managers (Vickers and Yarrow 1988; Shapiro and Willig 1990; Boyco, Shleifer and Vishny 1996). Poor monitoring results from the inability to trade firms in the market as in the case of private firms and this eliminates the threat of takeover or bankruptcy when the firm performs poorly. Thus, it is contended, both from the Property Rights and Agency School's perspective, that under privatisation or private ownership, there would be less political interference in the decision making of the firm, managers (and perhaps workers) would be better motivated with incentives linked to productivity and profitability norms, firms would operate under the discipline of commercial financial markets, while supervision by disinterested government bureaucrats would be replaced by that of self-interested shareholders. They would impose commercial profitability as the main objective of the firm and judge managers on

their success or failure to achieve this goal (Hemming and Mansoor 1988). And so, private owners, by virtue of their ownership, will reap the benefits of sound practice while PE officials, by contrast, have no such stake in their performance and thus lack the same incentive to operate efficiently (Hanke 1987; Van de Walle 1989).

Public choice theories postulate that an idealised notion of a fully informed and perfectly altruistic government, devoted to a maximisation of the people's welfare and perfectly responsive to the preference of its constituents, has no basis in reality. Politicians, bureaucrats and managers must be seen as people using their control of SOEs to further their own interests, rather than the firms' efficiency (Buchanan, Tollison and Tullock 1980; Niskanen 1971). Managers want more pay, power and prestige. They are interested in gross revenue as distinct from profits. The act of revenue maximisation leads inevitably to the expansion of output beyond profit maximisation levels. Hence, PEs will tend to operate inefficiently. The variables that may enter the bureaucrat's utility function are salary, perquisites of the office, public reputation, power, ease of managing the bureaucracy and ease of making changes (Niskanen 1971). They will thus expand the operations of the enterprise they are in charge of, especially as their salaries may be related to the expenditures they control. Besides, politicians always prefer to have direct control over firms to use them for distributing rents and reaching their political goals, and in the process, use public funds to pay off managers and solicit their cooperation (Shleifer and Vishny 1994). It is thus felt that privatisation would lead to improved economic performance by clarifying the objectives of the enterprise and freeing it from the burden of political interference and non-market criteria, and limiting politicians' ability to redirect the enterprises' activities in ways that promote their personal agenda or yield to short-term pressures at the expense of market efficiency.

Strong reservations have, however, been expressed in relation to the neoclassical and property rights arguments. Even if it is conceded that competition (or market structure), rather than ownership, dictates the efficiency of markets, the peculiar problems of developing countries need to be taken cognisance of (Commander and Killick 1988; Lesser 1991; Cook and Kirkpatrick 1988, etc.). In the developing countries, economic conditions are far removed from the demanding assumptions upon which the perfectly competitive model is built. Developing countries typically have both relatively small and relatively immature product markets. Thus, concentration is likely to be greater and the exercise of monopoly power more pronounced in product markets in the developing countries (Bhagwati 1984; Todaro 1989; Lesser 1991). The same is

also true for labour and financial markets (World Bank 1989). And Cook and Kirkpatrick (1988: 19) observe that the argument that the change in ownership will impose the discipline of private capital markets on the enterprise, thereby improving productive efficiency, may be important in industrial countries, but it has limited relevance to the developing countries. This is because the capital market is typically underdeveloped and denationalisation will normally involve the sale of the enterprise to individual purchasers, or the introduction of private capital into joint ventures. Even when it is argued, as the contestable market literature does, that the market only needs to be contestable in the sense of removal of artificial entry barriers, and that this will prevent monopoly abuse and guarantee allocatively efficient pricing practices by the monopolist, it is invariably the case that the conditions needed to satisfy the contestability model are rarely met in practice (Vickers and Yarrow 1985; Shephard 1984). And so, it is misleading to suppose that the elimination of artificial barriers to entry will in itself be sufficient to secure allocative efficiency gains. A particularly troubling deviation from the perfectly competitive model is the widespread existence of increasing returns to scale, giving rise to emergence of natural monopolies, and consequently PEs to capture the benefits of scale economies for the public sector at large rather than for the owners of monopoly capital (Commander and Killick 1988). But the advocates of free market solutions would suggest the device of 'franchising' with a system of competitive bidding among private operators.

A problem with the property rights or incentives argument is that it fails to consider the separation of ownership and management in the modern corporation where the owners of the property rights have limited control over management. There is considerable evidence that private managers do not necessarily act in the best interests of the owners at all times (Lesser 1991: 165; Cook and Kirkpatrick 1988: 13). And the fact of relatively underdeveloped capital markets in the developing countries will make it difficult to ensure that private managers stay relatively in line. Besides, is the criticism that allocative efficiency considerations are excluded from the incentive or property rights argument? Thus, according to Parker and Kirkpatrick (2005), the property rights and agency theories, with their emphasis on effective corporate governance, are obviously not applicable in the developing countries.

Perhaps, the above discussions can be summed up with the following observations. According to Adam, *et al* (1992: 4):

> 'when theoretical arguments for privatisation which are grounded primarily in the economic conditions of the developed countries are applied to the developing countries, the situation becomes much more

> complex. Competing goods and capital markets, high and efficient savings mobilisation and effective regulations are the exception in developing countries, rather than the rule. Their absence thus requires an adjustment of the way in which the theoretical arguments for privatisation are applied in developing countries. In particular, it is necessary to focus on the limitations of competition, the corresponding more extensive role for monopoly regulation and competition policy and on constraints imposed on privatisation by narrowly based capital markets.'

And as Lesser (1991: 164) has concluded, 'if the claims for privatisation depend on market liberalisation and if market liberalisation means highly imperfect markets, then privatisation means that one imperfect system is being substituted for another; the presumption of market superiority, which depends on the approximation of a perfect market, is no longer guaranteed'. Nevertheless, it will be shown in section 9, which deals with empirical review of the literature, that privatisation advocates have tended to produce results which appear to favour private ownership in the privatisation debate. The reliability of such empirical results is another issue, for as Fine (2005) observes, 'empirical assessments of privatisation are narrow in their focus. Findings are in the profitability of a selection of firms after ownership change. However, the conclusions are often extrapolated beyond what is merited, especially across countries and regions'.

Ideologies and Structural Adjustment Basis

There is no doubt that the relative poor performances of SOEs have elicited deep concerns, strengthening the case for reforms, which even the World Bank believes are possible. According to the Bank (1995: 109), reform is possible and offers potentially large benefits, which could contribute to more rapid economic growth. And as Commander and Killick (1988: 109) have observed, the movement for divestiture is symptomatic, not merely of a change in values, but also of what might be termed a simplification of the goals that former PEs are expected to pursue. The single and simple goal of profit maximisation is being substituted for the multiple goals of the state. Thus, in principle, such a simplification could be achieved without privatisation, by governments telling the managers of their state enterprises to pursue profit maximisation or some other single objective. But privatisation advocates are skeptical of this and so stick to divestiture, under the propelling force of ideology. The heart of the ideological case for privatisation is that the public sector is inherently incapable of doing any thing well and should be dismantled, and that private ownership is always better than public ownership. Economic and social policy should not be the concern of politics at all, but left to the market (Martin 1993: 51). Other analysts, for example Comman-

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der and Killick (1988) and Cook and Monogue (1990), believe that the current emphasis on privatisation in the modification of economic policy priorities does not exist in an intellectual vacuum. It can be seen rather as a part of a more general rehabilitation of the use of prices and markets as a mechanism for the allocation of resources, and of an intellectual disillusionment with more Keynesian and more interventionist approaches to economic management. And the general shift in the dominant paradigm towards a neoclassical market-oriented view of development, found a fertile ground in the election to power of strong conservative governments in a number of key industrialised countries. And in these countries, no concept is more sacred to the ideology of capitalism than private property. Thus, as Stiglitz (1999: 34) has stressed, it is not surprising that privatisation has become a centrepiece of the modern ideology of reform. Besides, Martin (1993: 9) has observed that the United States was chiefly responsible for spreading the neoliberal gospel, both directly through the United States Agency for International Development (USAID), and other channels through its domination of the World Bank and the International Monetary Fund (IMF) throughout the 1980s. The Reagan and then the Bush administrations in Washington were forever leaning on the Bank to move further and faster down the road of imposing privatisation. The structural adjustment programmes (SAPs) came in handy as instruments.

Privatisation and commercialisation have been central components of the SAPs foisted by the World Bank on indebted Third World countries. They have been part of a much larger reform agenda involving changes in macroeconomic policies, restructuring of the role of the state and developing or strengthening the role of market forces. It has been asserted that the major justification for privatisation, from the World Bank's perspective, is that the private owner is using more efficiently the resources previously used in a less than optimal manner in the PEs (Nellis and Kikeri 1989: 667). The Bank, it is further claimed, views privatisation not as an end in itself, but as one of many means to help governments increase the efficiency of both government and business. And with the Bank's assistance for the process, many countries have been looking to privatisation as an efficiency enhancing measure. In practice, however, the Bank does not just see privatisation as 'one of the means' but the means to the economic salvation of poor countries. And given the fact that there are reservations on the ownership and efficiency arguments, why does the Bank not relent in its imposition of privatisation on the developing world that has embraced it as an article of faith in economic adjustment? The pressure to improve the performance of the PE sector through privatisation has also been reinforced through the conditions of

IMF programmes and lending. In a survey of 94 Fund-supported programmes in developing countries, it was found that 68 of the programmes included policy recommendations relating to non-financial SOEs aimed at improving financial performance (From Mosley 1988 in Cook and Monogue 1990: 390). With respect to Africa, a World Bank economist, Alexander (1992), informs that all the Africa region's SAPs already, or are planned to, incorporate features to address PE questions. The programmes frequently entail the following, the closure and/or divestiture of specific PEs, a curb on future investments in new PEs; limits on investment by existing PEs; liberalisation of price controls, deregulation of monopolistic practices by PEs, cuts in labour forces, etc.

It is, perhaps, pertinent to observe at this juncture that some proponents of privatisation see it as an end or goal in itself (Vernon-Wortzel and Wortzel, 1989: 633). They operate from an ideological premise that as many sectors and activities as possible should be in private rather than government hands. Their arguments are based on deep-seated conviction about the efficiency of free markets and the importance of ownership in guiding enterprise behaviour.

However, it may be observed that in recent years there has been an apparent rethink over privatisation by the World Bank. For a long time, it had become conventional wisdom for it and others to see the private sector as preferable to the public sector, despite limited analytical and empirical support upon close examination. The faith in privatisation was seen as unshakeable and unquestionable. And the World Bank fanatically pursued privatisation. But the Bank now accepts in principle that privatisation is not always justified and that in practice results have sometimes been disappointing. In other words, it is inclined to believe that "privatisation has been oversold and misunderstood" (World Bank 2004a). It's latest posture accepts, on a case-by-case, not-one-size-fits-all, basis that there can be a rationale for continuing public ownership in principle, despite "the fact that state ownership is flawed", and offers the case of Brazilian Hydro in practice (Fine 2005: 6). However, the essence of the Bank's apparent shift in position is not to give public enterprise another chance. Rather, it is to identify what pre-conditions of competition and regulation that the state must put in place in order to make privatisation successful.

Nellis (2003: 12), an associate of the World Bank, observes that there is a strong association between institutional density and capacity and positive privatisation results, in both efficiency and equity terms, of ownership change. And that low-income countries in general, and African countries in particular, rank low in terms of institutional density and capacity. He thus lists the institutions which must be in place and working, the absence of which privatisation

will produce sub-optimal, perhaps negative, outcomes. These institutions include the definition and protection of property rights, contract enforcement and commercial dispute settlement through lawful, peaceful means or, more broadly, court decisions that are timely and based on the law, not payments; a degree of regulatory capacity; functioning bankruptcy regimes; and a public administration that meets modicum standards of predictability, competence and probity and thus lowers transactions costs. The Organisation for Economic Cooperation and Development (OECD) (2004) similarly points to pre-conditions for successful privatisation, among which are good governance, an appropriate presence and balance of competition and regulation, government ownership and commitment to the privatisation process, rather than conforming to the dictates of donors and imposed conditionalities. Thus, the OECD, like the World Bank, seeks to promote privatisation by redressing the deficiencies of the neoliberal approach. It is concerned about what needs to be added to the market to make privatisation work and, hence, promote further privatisation. Thus, it can be argued that the neoliberal approach, which underpinned the World Bank's previous stance, has gone into decline in its pure form.

Fine (2005), points to the bias in the approach of the OECD and the World Bank in favour of market provision, even as the deficiencies of the market are increasingly being recognised as an obstacle to further privatisation itself, and advocates extension of the system of public service provision (SOP) approach from (private) consumption to public services. The public service system of provision approach (PSSOP) emphasises the integral and unique nature of service delivery across each sector. Corresponding to this analytical approach is a policy approach in which each public service would be attached to an "authority" dedicated to that purpose, – a health authority, education authority, etc. – which would have responsibility for coordinating provision through identifying strengths and weaknesses in the PSSOP and where, appropriate, drawing upon or rectifying them, respectively. The approach represents a mix of public and private structures, agents and processes in the quest to address public service delivery.

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Chapter 4

Concept of Privatisation

Defining privatisation has turned out, in the literature, not to be as simple as the concept appears to be. To Berg (1988), the concept of privatisation is a lot more complicated than the selling of state-owned enterprises, the more so as there is no clean dichotomy between public and private sectors, and no nicely homogenous area of economic activity separated by a clear frontier. Rather, to him, every economic activity is a blend of public and private elements, each of which is itself more or less 'impure'. Others have viewed the concept in a similar vein: as having predictably become a problem (Heald 1990: 4); a fuzzy concept that evokes sharp political reactions (Bienen and Waterbury 1989: 617); a term used to convey a variety of ideas (Ramanadham 1992: 4), and as an umbrella term covering a number of government microeconomic policies (Bishop and Kay 1999: 643). And Martins (1993) considers privatisation in terms of change in the role, responsibilities, priorities and authority of the state, rather than narrowly to denote change of ownership. The difficulties implied by these perspectives notwithstanding, it is possible to delineate two lines of definitions of privatisation: the broad definition and the narrow definition (Obadan 2000). The broad definition is conceived in the context of the counter-movement to the growth of government that has characterised much of post-World War II period in industrial and developing countries (Bienen and Waterbury 1989). Accordingly, privatisation, in a broad sense, refers to all policy initiatives and measures designed to alter the balance between public and private sectors in favour of the latter (Cook and Kirkpatrick 1988), and hence strengthen or broaden the scope of private sector activity in the economy (Boorsma 1994; Bouin and Michalet 1991; Adam, *et al* 1992). The broadening of the private sector's role implies the reduction or elimination of the public sector's role in economic activity (Commander and Killick 1988). The policies and actions of the government range from denationalisation, divestiture to leasing and franchising, to deregulation and liberalisation.

Accordingly, the following are considered as privatisation under the broad perspective:

- Sale of a public enterprise in full to private buyers, or introduction of private capital into the PE either through a sale of some government equity or in the course of its expansion. The larger the private equity proposition, the greater the privatisation;
- Liquidation, which represents the ultimate step in the arsenal of the government. It may imply a sale of the assets to someone who uses them in the same activity or moves them to another activity (Ramanadham 1992: 6);
- Management buy-out, which entails sale of the assets to the employees of the PE who take over the ownership;
- Privatising the management of state activities through contracts. Management of contracts involve the use of management expertise from the private sector to manage government entities through the payment of a fee;
- Transferring of the provision of a good or service from the public to the private sector while the government retains the ultimate responsibility for supplying the service; for example, franchising or contracting out of public service and leasing of public assets (Cook and Kirkpatrick 1988). The contracting out of activities is often seen as likely to provoke less opposition than the sale of assets, and it may yield equal or greater outcomes/ returns;
- Build-operate-transfer (BOT) or build-own-operate system. This is one method used for new projects, which are normally undertaken by the public sector, such as infrastructure projects and public utilities (Obadan 2000: 16). Under this method, the public facility concerned is built by private-sector firms using their own resources and is run by them under a period of concession; and
- Liberalisation or deregulation of entry into an activity previously restricted to PEs. The removal of restrictions implied by this is to allow private operators to compete in sectors that have been the exclusive domain of PEs. To the extent that private enterprises are successful in entering the hitherto protected markets, a variant of privatisation would have occurred, even though no transfer of ownership of assets had been involved (Cook and Kirkpatrick 1988). Apart from removing restrictions, the liberalisation

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policy may involve restructuring existing companies into more competitive units (Bishop and Kay 1999). In the case of a break-up of a monopoly in which the ownership and control remain in public hands, the only notable private-sector feature is the possible competitive spirit that is likely to be engendered (Obadan 2000: 16). And very importantly, liberalisation is significant where it is felt that competition, rather than ownership is the key to efficiency, hence state industries are reformed by opening them to competition.

Thus, many features of the broad definition, other than the sale (full or partial) of a public enterprise, reflect the views of pragmatic analysts who see virtue in the reform of PEs through the application of efficiency enhancing techniques generally employed by the private sector. This contrasts with the perspective of those who take an ideological position that private ownership is always better than state ownership and, hence, see privatisation only in terms of ownership transfer. They do not believe that the deficiencies of PEs can be remedied without changing ownership, but buttress their arguments with findings from the principal-agent literature which imply that a change in ownership *per se* can affect economic performance, all other things being equal (Kikeri, *et al* 1994: 244). It is contended that by reducing the number of principals to a single owner whose overriding objective is to maximise profits, privatisation greatly simplifies the principal-agent problem and creates the potential for efficiency gains. This is why a number of scholars and analysts have viewed the broad definition of privatisation as an inconvenient way of classing together a number of very disparate measures (liberalisation, restructuring and deregulation), thus making interpretation difficult (Bouin and Michalet 1991: 114), or as loose, resulting in privatisation being viewed as a goal in itself rather than simply as a means to an end, which can lead to confusion (Adam, *et al* 1992).

Hence, a narrower definition has been proffered in terms of ownership transfer. Privatisation, in this context, refers to the transfer of majority ownership of state-owned enterprises to the private sector by the sale of ongoing concerns or of assets following liquidation (Kikeri, *et al* 1994), or as the transfer of ownership and control of public enterprises to the private sector (Jones 1991; Todaro 1989; Hemming and Mansoor 1988; Heald 1990; Dijk 1994, etc.). Adam, *et al* (1992) consider privatisation as a process which covers the transfer from the public to the private sector of the ownership and/or control of productive assets, their allocation, and pricing and to the entitlement of the residual profit flows generated by them. This enabled them to conceive as privatisation in their study, outright or partial sale of assets by the state, transfer of assets to the private

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sector under leasing arrangements and introduction of management contracting arrangements. Nevertheless, it appears that privatisation, as has become popular in the context of past and ongoing programmes, relates to the sale of state assets or shares in public enterprises. The sale may involve all or some of the equity interests of an enterprise. And considerations of where the operational control lies have also become important issues in privatisation. But as Adam, *et al* (1992) observes 'no definition of privatisation is ever likely to be watertight, and in many cases, the extent to which "privatisation" has occurred is a matter of degree and interpretation'. In any case, how the countries of SSA have defined privatisation is an empirical issue, which the proposed study on impact of privatisation should throw light upon.

Chapter 5

Objectives of Privatisation

In the light of the motivation to privatise SOEs, policy objectives are stated in privatisation programmes by governments. It often turns out, however, that some objectives are not stated, such as, for example, the need to reward political loyalists and meet the conditions of external financing agents such as the World Bank and IMF, in anticipation of financial and technical assistance from them. The objectives of the programme will influence the type of privatisation adopted, the method of implementation, the associated policies towards deregulation and financial restructuring (Obadan 2000: 21). In addition, in order to assess the success of a programme, outcomes need to be measured against the objectives that governments had set for privatisation. Besides, objectives which are usually articulated in policy statements and documents guide implementers and inform the public about what a privatisation programme is designed to achieve and how the programme will achieve its aims (White and Bhatia 1998:21). However, some countries express objectives in such general terms, and without related targets for achievement, that an objective judgement of the impact and success of the privatisation exercise becomes difficult, if not impossible. Some objectives relate to economic gains while others stress socio-political gains, especially in socialist countries undertaking reforms. Nellis (1991) writes that governments attempt to privatise SOEs for the following reasons: raise revenue, create popular capitalism; reward political loyalists; placate the demands of external financing agents to decrease the administrative burden of the bureaucracy, and make the private sector responsible for needed enterprise investment. But Parker and Kirkpatrick (2005) opine that in the developed economies the prime objective of privatisation, leaving aside raising funds for government, is to increase economic efficiency, but that in the developing countries, the primary goals are obtaining maximum output from scarce resources, poverty reduction and sustainable economic development.

In the United Kingdom, the privatisation programmes developed in pursuit of a variety of objectives have had higher priority at different times (Bishop and

Kay 1989: 648). Thus, initially, the advocates of privatisation championed its role in diminishing the authority of public-sector trade unions. Then, they welcomed its financial impact on the public-sector borrowing requirements and applauded its reaction to wider share ownership. Finally, the advocates have stressed its effects on business performance — in bringing about significant improvements in the efficiency of privatised companies. Essentially, at different times, each of these objectives — revenue, efficiency, finance, wider share ownership — has been sacrificed for others. According to Bishop and Kay, *op.cit*, privatisation appeared to meet particular political needs at particular moments in time. An idea born of anti-unionism thus grew through the public-sector financial expediency and conservatives' preference for increasing competition, through the private sector, into a populist transfer of major monopolies. In Africa, the objectives of raising additional revenue and promoting economic efficiency and, as a result, reducing the budgetary burden on the states, appear to have been paramount, even though a number of others are also indicated. Perhaps, the unstated major motivation for privatisation has been to placate the international financial institutions (Nellis 2003: 6; White and Bhatia 1998; OECD 2004). Indeed, as White and Bhatia, *op.cit*, indicate, the governments of Africa have not always adopted privatisation for the reasons stated. The privatisation process has been prompted in many cases by economic necessity and enabled by the political changes occurring across the continent. Although reduction of fiscal deficits is commonly cited as the main objective, the choice of enterprises for privatisation suggests that the primary motivations for privatisation have been the need for World Bank, IMF and donor financial support as well as the need to generate proceeds. In the Ugandan privatisation of the 1990s, Tangri and Mwenda (2001) observe that the government set aside its own reservations in deference to international financial institutions and access to aid. There are thus interesting issues to resolve through empirical analysis in a study of the impact of Africa's privatisation: the real motivations and objectives of privatisation and the role of international financial institutions and donors.

In general, from policy statements and analyses across the range of developing countries, the following principal objectives of privatisation emerge (Adam, *et al* 1992; Parker and Kirkpatrick 2005; White and Bhatia 1998; Obadan 2000; Dijk and Nordholt 1994; Bishop and Kay 1989; Nellis 1991, etc.):

- Public finance rationalisation — reducing fiscal deficits through reducing net budgetary transfers and eliminating contingent external debt liabilities; increased tax revenues on enterprise output and receipts from privatisation sales;

- Improving economic efficiencies (productive, allocative and x–efficiencies). These are to be reflected in lower product prices and improved quality of products;
- Broadening ownership of businesses through wider shares and assets ownership, thus creating popular capitalism and fostering economic equity;
- Developing the capital market and deepening the financial system;
- Generating new investment, including foreign investment, and enabling enterprises to access markets, capital and technology, as well as expose them to market discipline;
- Reducing government involvement in the economy and shifting the balance between public and private sectors, as well as developing the private sector. This is a more ideological and controversial objective as it rests on the idea of diminishing the role of the state; and
- Providing the opportunity to introduce competition. African countries, however, may not have been citing this as a specific objective of privatisation, although it may be inferred from some other objectives.

The above objectives tend to be a set of desirable goals that appeal to a broad cross-section of stakehoders in the society. They are sometimes mutually reinforcing, but sometimes conflicting, or are not mutually consistent (Heald 1990: 7; Obadan 2000: 22). This is the case of broadening ownership, which is often at variance with maximising price and other benefits. Besides, although the objectives of privatisation contain both the economic and the political, the international community, in trying to be politically neutral, employs economic criteria in measuring the progress of privatisation (Dijk and Nordholt 1994: 7), thus yielding a partial assessment of the impact. Finally, the contribution that privatisation makes to any particular objective may often depend on the simultaneous implementation of other policy measures such as competition and regulation policies.

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Chapter 6

Principles and Methods of Privatisation

The literature recognises some principles, which guide the privatisation process while a number of methods/techniques are used for divestiture — permanent or temporary transfers of public assets to the private sector.

Guiding Principles

The principles relate to speed, establishing effective ownership, fairness and role of foreign capital/expertise (Nikpay 1993; Kornai 1990; Bolton and Roland 1992; etc.). The argument is that privatisation should proceed as quickly as possible, and massively too, for the political reason that in almost all countries where the case-by-case approach has been attempted there have been major political obstacles (Nikpay 1993: 1). And with respect to Eastern Europe, it was felt that the demise of central planning and the subsequent pattern of (*de fact*o) ownership have created the potential for massive inefficiency, which can only be rectified through a change in ownership. But some authors, notably Kornai (1990: 82), argue that it is important that 'state property is not simply handed out, but rather placed in the hands of a really better owner'. Kornai further contends that fast privatisation will, in many cases, result in a mismatch between enterprises and new owners. Although Kornai's perspective has been criticised, some other scholars have provided support. Bolton and Roland (1992) who made reference to improvements in the productivity of China's SOEs following that country's reforms, argue that with an appropriate incentive structure, managers and workers can be induced into improving productivity. And, in making a more substantial case against rapid privatisation, Akuz (1992) criticises the assumption in the literature about a sudden emergence of a capitalist class 'once

state property is transferred to the man in the street'. The point is that this will require provision of cheap credits, tax breaks, subsidies, etc., to allow the accumulation of capital and know-how (as in the developing countries). In turn, this requires a major political reform to transform the state's machinery into one capable of promoting capitalism. All these necessarily take time and must precede large-scale privatisation. And providing some support (though not intended) for the case against rapid privatisation is the conclusion of Nellis (1999:4) in his 'Time to Rethink Privatisation in Transition Economies': "for what seemed excellent reasons, the emphasis was usually on massive, speedy transactions with substantial ownership stakes awarded to 'insider' stakeholders... in these instances, the speedy, massive, insider-oriented forms of privatisation have generally not, so far, led to the restructuring required to allow firms to survive and thrive in competitive market operations".

The principle of establishing effective ownership relates to the need to create a structure of ownership in which the owners exercise effective control over enterprises. In some forms of ownership, the 'principal-agent' problem is deeply manifested, whereby owners delegate power to managers who have less than complete incentives to act in the owners' interests. In the 'pure voucher scheme' method of privatisation, each SOE is left with potentially millions of shareholders who would be powerless to influence management. Consequently, the literature has stressed the need for optimal structure for corporate governance. In this direction, the approaches suggested include takeovers and systems of ownership in which banks play a crucial role in supervising the managements of corporations (Nikpay 1993: 6). The issue of fairness is emphasised by most analysts as a crucial element of any privatisation programme. The point is that any privatisation which results in an unequal distribution of wealth (regardless of the sense it makes from an economist's viewpoint) will face great opposition and may also weaken support for the reform process. Two-thirds of a sampled population in Poland regard social justice as one of the basic principles of privatisation against 30 per cent, which stress economic efficiency (Nikpay 1993). Finally, the issue of assured access to foreign capital and expertise is considered important in capital scarce economies. The economies of Eastern Europe, and perhaps, poor SSA countries, were considered to badly need Western funds and technology, and overseas buyers of PEs represent a notable source for this. But the fear of economic domination by powerful foreigners is quite real and the governments may have to contend with the political opposition it elicits.

Overview of Divestiture Methods

Many methods or techniques are available to countries embarking on privatisation (see for example, Nankani 1990; Schwartz and Lopes 1993; White and Bhatia 1988; Nikpay 1993; Bouin and Michalet 1991; Commander and Killick 1988; Obadan 2000). Countries have used some of them in different degrees and combinations. The choice of any of the methods for divestiture depends on a number of factors: objectives of the privatisation, the PEs' financial condition and performance record; the ability to mobilise private-sector resources, especially through the capital markets and the political environment (Obadan 2000; Bouin and Michalet 1991). Thus, for example, the method of one-by-one asset auctions are most appropriate when policy makers wish to maximise privatisation proceeds; public offering of shares can help to achieve widespread ownership while, along with mass privatisation, it creates popular capitalism; employee buy-outs create labour-capitalism; leases, concessions and management contracts are useful where political decisions on divestiture are hard to take and temporary privatisation seems more expedient. The methods identified in the literature can be grouped into two categories: a) those that involve the transfer of ownership from the state to the private sector. These include: sale of shares, sale of assets, management or employee buy-outs, equity dilution, joint ventures, and liquidation; and b) the methods that entail temporary privatisation (no ownership transfer) are leases, management contracts and concessions/franchises. Some of these are explained as follows:

Privatisation Methods Involving Ownership Transfer

These methods, it has been argued (Kikeri, et al 1994: 259), have a big advantage over divestiture methods that do not privatise ownership. It is that sales of assets transfer property rights to profit-oriented owners who have an incentive to improve performance. The methods include the following:

a) Public Sale of Shares

This may take the form of public floatation of shares to the public through the stock exchange, or sale of shares to private investors through competitive means, usually through open competitive tender. These are fairly transparent methods. The public offering method is highly favoured in the developed countries, but it calls for conditions which are seldom fulfilled in the developing countries. The complexity of the preparatory stages restricts its use to the major PEs. The public offering method is seen as a means of 'democratising' the shareownership in main sectors. Democratisation of shareownership demonstrates that privatisation is not taking place solely for the benefit of powerful national or foreign

financial groups. The method is also expected to develop the capital and securities markets, and allow governments to reaffirm their commitments to privatisation (Bouin and Michalet 1991). However, the absence of developed capital markets has tended to prevent the widespread use of the public-offering-of-shares approach in many developing countries that have implemented privatisation programmes (Obadan 2000; Commander and Killick 1988, etc.). In the case of Africa, Nellis (2003: 20) observes that although the sale of shares through a public floatation is generally thought to be about the most transparent sales approach, it has rarely been applied in the continent (outside of Nigeria and South Africa) in part because of the thin or embryonic nature of capital markets in most countries. And Nikpay 1993, observes that the absence of required financial infrastructure means that traditional objective forms of enterprise valuation are almost impossible, and without fully functioning and developed stock markets, measures such as price earning ratios are meaningless, resulting in the circumstances of unobjective valuation. Besides, sales may allow existing owners of financial capital to acquire an even greater fraction of the nation's wealth thus increasing inequality further and violating the principle of fairness.

b) Private Sale of Assets or Shares

The private sale of equity or assets makes it possible to integrate debt conversion into the financing arrangements. The sale of shares or assets to private buyers appears to be the transfer method most often used in the developing countries. The sale of assets can be done through competitive sale by public auction or through non-competitive sale (direct sale of assets to private investors). The latter method, however, elicits concerns among stakeholders about fairness and transparency. Compared with public offerings, the preparatory stages of private sales are not complicated and therefore have the attraction of a procedure that is both flexible and speedily implemented. The risks/problems inherent in private sales are similar to those in the case of public offerings: determination of minimum transfer price, narrowness of securities markets and selection of target firms. The success of such direct sale procedures, and of transfer operations, in general, depends primarily on the financial position of the firms to be privatised. Where all the assets have been privatised but the enterprise is not, a formal winding up process would have to be initiated.

c) Free Distribution Model

As a result of the problems of the sales model, advocates of privatisation have argued on the premise that if SOEs could not be sold, they would have to be given away. This would dispense with the problems of the sales model (need for

valuation of SOEs and low liquidity in the private sector) and result in rapid transfer of ownership rights. But then, other difficulties remain, regarding the allocation mechanism for ownership, control of enterprises and the role of the state in the process (Nikpay 1993). Nevertheless, the important variants of this model are: (i) worker or self-management and (ii) free-distribution to the general public.

(i) The Worker or Self-Management Model: This entails the transfer of ownership rights to the workers of each enterprise. The argument which favours this rests on the assumption that since employees will share directly in increased profits, employee-owned firms are likely to be more productive than firms owned by outsiders (because of increased effort). But economic theory suggests that such firms will not behave in this manner, but will instead suffer from under-investment and shorter planning horizons (see Blinder 1990). Also, if shares are not transferable, workers mobility will be highly impaired. Besides, transfer of ownership rights to workers will result in a highly inegalitarian distribution of wealth, as few workers benefit at the expense of the majority of large segment of the population. Furthermore, it will be highly difficult to attract private investors to acquire a minority stake in a worker-controlled enterprise because workers could curtail dividend payments by granting themselves salary increases (Nikpay 1993). And so, labour ownership has generally been rejected in the literature.

(ii) Free Distribution to the General Public: This offers a potentially equitable and efficient response to the need for rapid privatisation, unlike the give-away to workers. If properly conducted, no special group with access to money, credit or power can exercise untoward influence in cornering the nation's wealth. But the method attracts the criticism that people cannot fully appreciate the value of assets unless they pay for them and so are unlikely to devote the time and energy required to supervise management. It is felt that the best owners are those who will be prepared to risk their money on the acquisition of enterprises (Kornai 1990). Besides, there is the problem posed for effective control over management by a highly dispersed ownership of shares, although it may be politically desirable. For example, where the 'pure voucher scheme', whereby the state equally distributes special vouchers to all citizens to purchase shares in enterprises of their choice, is used for the free distribution, then each purchaser will be able to own only a tiny fraction of any enterprise, and will not be able to exercise any effective control over management. In the literature, the

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main approach suggested in dealing with the above problem relates to the creation of financial intermediaries that would hold shares in the individual enterprises with the public in turn owning the equity of these intermediaries. But as Nikpay (1993) rightly points out, the problem with such proposals is that they fail to identify ways in which the actions of the intermediaries themselves could effectively be supervised.

d) Staff or Management Buy-Outs

Special employee or management buy-out schemes target specific groups of potential buyers — staff or management of designated enterprises. Here, two modalities are involved, leading to employee/management ownership. First is the acquisition of a majority holding financed from employees' own resources or by debt secured over the firm's assets?

Secondly, the scheme may entail certain percentages of capital earmarked for employees in the context of a public offering or private transfer. There are cases where the employees are the main actors in the buy-out or where employees' share ownership is a complementary procedure, perhaps, because of limited financial resources (Bouin and Michalet 1991: 134). The acquisition of shares under the scheme can be through either a competitive process or a non-competitive process.

Privatisation Methods Not Involving Ownership Transfer

While the methods entailing transfer of ownership have been the principal mode of privatisation, the mechanisms pose some major problems (Commander and Killick 1988: 11). The first, as was noted before, relates to the underdeveloped nature of the capital market in the developing countries, in terms of the size of the market available to a divesting authority, limited capitalisation and number of traded issues. These remain a major barrier to the public offering or equity sales method of transfer. A number of countries in SSA do not have organised capital markets. The second problem relates to the domestic political opposition from labour groups and political lobbies against privatisation. And thirdly is the potential profitability of the PEs to be sold. For example, divestiture of loss making PEs is only likely to be feasible when significantly sweetened by market and tax concessions. Therefore, some governments have found alternatives in management contracts, leases and concessions in their bid to imbibe private sector practices and strengthen the role of the private sector (World Bank 1992; Dijk 1994; Bouin and Michalet 1991). Leases, concessions and management contracts aim to increase the role of private investors and managers, without necessarily leading to the transfer of ownership of the firms or activities concerned

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(Bouin and Michalet 1991: 137). The basic principle underlying them is the need to improve the firms' management and efficiency.

(i) Management Contracts

Management contracts define the relationship between the government and a private firm contracted to manage a state-owned enterprise (World Bank 1995a: 6). Essentially, a management contract places a public enterprise under private management for a specific period of time. The ownership of the assets remains with the PE and ownership of shares remains unchanged. In the short-term, a management contract strengthens the role of the private sector by entrusting to it responsibility for the activities of an SOE. It focuses action on improving the management and making potential entrepreneurs compete on criteria of efficiency. For the management services, the contractor is paid a fee which may be based partly on performance. One disadvantage of the management contract is that contractors typically do not assume risk, and losses are borne by the state. The government continues to make financial provision for the operating costs and investment, as the private contractor has no responsibility for this at all. Another is that the flat-fee-for-service arrangements provide little incentive to improve efficiency and maintain the value of the assets (Hegstad and Newpont 1987). Thirdly, at the level of investment and social welfare, there is the risk of conflict between the state and the new managers. The managers may tend to overinvest (with state funds) in order to increase productivity rapidly. Also, the managers may achieve the enterprises' recovery at the expense of employees in terms of massive redundancies, wage cuts, etc. Both cases thus entail high financial and political costs to the state (Bouin and Michalet 1991). Perhaps, these partly account for why, as the World Bank (1995a) observes, management contracts are not widely used. But they have generally been successful where they were attempted. And so, to the Bank, management contracts with the private sector are the preferred course (in relation to other contracts), although it believes that they are useful only in a limited number of circumstances where the enterprises' technology changes slowly and output is primarily a single, homogeneous product or where quality is easily monitored. And the observed problems can, however, be minimised with properly drawn contracts. But, especially, in the poor countries, this will require strengthening governments' capacity to monitor and enforce contractual obligations (Kikeri, *et al* 1994).

(ii) Leases

A lease occurs when a private operator is given custody, for a specific period of time, of some or all of the assets of a PE to employ them in a productive manner.

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The private lessee has full operational and financial control of the assets essential to the firm's activity, and in consideration, the lessee undertakes to pay an annual rent to the state, however the financial situation develops (Obadan 2000; Bouin and Michalet 1991). As assets ownership remains with the PE, and shares ownership remains unchanged, temporary privatisation of the enterprise takes place and lasts as long as the lease arrangement. For the state, lease is an attractive option because it:

- frees the state from responsibility for the enterprises' operating and investment costs;
- generates a stable income;
- encourages competition between different potential lessees;
- retains public ownership over assets whose value increases with the improvement in management and financial results; and
- avoids the three-fold problem posed by transfer procedures in developing countries — lack of financial resources on the part of purchasers, problem of fixing the transfer price and obstacles of political and legal nature (e.g. existence of non-transferable assets such as land).

Thus, a lease overcomes some of the drawbacks of management contracts because the private lessee, who pays the government a fee to use the assets, assumes commercial risk and has more incentives to reduce costs and maintain the value of assets. Lease arrangements are reported to have been widely used in Africa in sectors that have difficulty attracting private investors — water supply in Côte d'Ivoire and Guinea, power in Côte d'Ivoire, port management in Nigeria, etc. (Kikeri, *et al* 1994: 260). Nevertheless, the main problems relate to renewal of lease, changeover from lease transfer and state control before, during and after execution of the lease (for details, see Bouin and Michalet 1991*:* 138).

(iii) Concession

This is a contractual arrangement whereby, in return for a negotiated fee, a private operator is awarded a licence to provide specified services over a certain period of time (White and Bhatia 1998; Obadan 2000). A concession is often used to condition the natural monopoly status of large enterprises providing utilities, for example, electricity, water supply, and telecommunications. The private operator is responsible for capital expenditures and investments as well as existing assets. But the ownership of the principal assets remains with the PE and ownership of the shares remains unchanged. Thus, the method results in

temporary privatisation of the service and lasts as long as the concession itself. A concession is more desirable for the government but less feasible than leases because private financing tends to fall short of the needed investment, especially in sectors or countries where political and economic risks are high.

Concluding Observations

A few points are made as follows: First, the use of any of the above methods, entailing the transfer of ownership from the public to the private sector, is conditioned by the economic, financial and political environments prevailing in the developing countries. The non-existence or narrowness of stock markets, difficulty of assessing the value of assets of enterprises concerned and the concentration of capital in the hands of several dominant groups are all potential checks on the satisfactory progress of transfer operations. Secondly, if selling SOEs is politically or financially difficult/unfeasible, then alternative ways to improve SOEs efficiency can be explored in management contracts, leases and concession arrangements. These are options which enable certain activities to be carried out by the private sector in the framework of public-private partnership. However, some advocates of privatisation are highly skeptical of SOE reform. To Shirely and Nellis (1991), public enterprise reform is no alternative to privatisation. This is because in low income countries, such reforms face technical and political difficulties during implementation and suffer from the failure to adopt all the linked elements of a reform programme. Also, they point to persistent backsliding; the enormous difficulty of sustaining reforms once introduced. Finally, up to December 1996, 16 methods of privatisation had been employed in Africa (White and Bhatia 1998: 72; Makalolou 1999: 6), with 32 per cent of transactions (for which information on the method used was available) involving the sale of shares by competitive tender. Other notable methods were liquidation, competitive sale of assets, direct sale of shares, leases and concessions, etc. By 2001, the number of privatisation methods, as listed in Nellis (2002: 21), was 20, with competitive sale of shares or assets still being predominant (Table 1). Methods to broaden ownership, such as voucher schemes and management/ employee buy-outs had not been commonly used. And White and Bhatia (1988) observe that the problem with all the other methods for broadening ownership that had been tried in Africa is that they directly reach only the minority of citizens who have savings or are employees in enterprises in which equity participation is available. They state further that a significant proportion of the people, which is very poor, does not directly gain from or obtain any indirect benefits from privatisation.

Thus, many years after the 'premier' descriptive study of privatisation in Africa, and with more major privatisations undertaken, there is the need for a follow-up study which will address pertinent issues and questions such as the actual privatisation methods and the motivation for them. Are they adequately designed and implemented? Do they entail transparency? Who are the winners and losers that the privatisation methods have thrown up? Are the methods aimed to broaden ownership successful? Are there any rooms for alternatives to ownership transfer?

Table 1: Methods of Privatisation in Africa (1991-2001)

Method	Number
Shares sold on competitive basis	726
Assets sold on a competitive basis	454
Liquidation	386
Shares sold to existing shareholders with pre-emptive rights	158
Lease	104
Direct sale of shares (i.e. non-competitive)	94
Shares sold through public floatation	69
Not specified	48
Restitution to former owner	47
Management contract	42
Management/Employee buy-out	33
Direct sale of assets (i.e. non-competitive)	29
Joint-venture	28
Free transfer of assets	12
Transfer to trustee	11
Debt-Equity swap	10
Concession	8
JV(D)	5
Lease/Management contract	2
Merger	2

Source: Nellis (2003: 21)

Chapter 7

State of Africa's Privatisation

As was observed in Section 1, privatisation, as a major instrument of economic reform, has, since the late 1980s, been stepped up significantly in almost all African countries, such that as at the early 21st century, there is hardly any African country that does not have some kind of privatisation programme in place. As at the beginning of 1990, about a dozen countries in Africa had been involved in privatisation transactions of some kind. And it seems that the French-speaking countries were among the pioneers (Makalolou 1999: 4). Six of them (Benin, Central African Republic, Guinea, Niger, Senegal and Togo) started between the 1970s and the mid-1980s. By 1993, a second group of countries (Cote d'Ivoire, the Gambia, Ghana, Kenya, Madagascar, Malawi, Mali, Mozambique, Nigeria, Uganda), implementing simultaneously Bretton Woods Institutions-supported adjustment programmes and public sector restructuring policies, had joined. By 1996, all but five countries had divested some PEs (White and Bhatia 1998: 69). As the number of countries in the privatisation train increased (40 for which records of transactions were available as at end 2002), the number of transactions also increased. According to White and Bhatia (1998: 69), 'more and more countries have embraced privatisation.' Up to 1990, a total of 334 privatisation transactions were recorded. This number had increased sharply to about 2,600 by the end of 1996, with a combined sales value of some US $2.9 billion. Table 2 shows that up to the end of 2002, the total number of transactions had risen to 3,672 (all Africa) and 3,486 (SSA) with sales values being US $7.3 billion and US $6.7 billion, respectively. Perhaps, because of data coverage problems, the UN-ECA provides different figures: a total of 2,270 transactions from 1991-2001 with a much higher sales value of US $9.1 billion (Table 3). The Commission considers the volume of transactions as representing only about 40 percent of Africa's SOEs and that much of the divestiture has been for smaller, less valuable, often moribond manufacturing, industrial and service concerns. Because of this, Nellis (2003) considers African countries as generally being

slow and reluctant privatisers with a good percentage of industrial/ manufacturing and most infrastructures still remaining in state hands. The OECD (2004) similarly concludes that Africa has been poorly served by privatisation.

However, in recent years, the value of transactions has significantly increased, with attention focusing more and more on larger enterprises, including the telecommunications and electricity sectors. Concern has been expressed about the concentration of privatisation in a few countries, such that of the US $9.1 billion realised from 1991-2001, a third was generated by a handful of privatisations in South Africa. Another third came from sales in Ghana, Nigeria, Zambia, and Côte d'Ivoire. However, many countries have been intensifying efforts in the direction of privatising their PEs. But the UN-ECA reports that a few countries (Cameroun, Egypt, Gabon and Niger) by 2003, were finding it difficult to accelerate the pace of privatisation due to concerns about possible outbreaks of violence and resistance by trade unions and other interest groups.

In the sphere of impact, White and Bhatia, 1988, observe that because up until 1995, privatisation throughout Africa focused primarily on small enterprises, its impact on fiscal deficits, economic efficiency, foreign investment and employment had been small. Generally, the results from privatisation, where it has occurred, appear to have been more mixed than elsewhere. According to the OECD (2004), the absence of necessary preconditions for successful privatisation has given rise to undesirable outcomes – limited scope for promoting indigenisation of ownership and bribery and corruption. But the World Bank (2004) claims that the well over 3,500 privatisation transactions that were reported across Africa up to the end of 2002 have brought about fundamental changes, among which are:

- the fiscal burden of public enterprises has been reduced or eliminated.
- privatisation receipts have contributed to a reduction in fiscal deficits.
- privatisation has attracted foreign direct investment both to acquire enterprises and for post-privatisation investment in those businesses.
- the process has stimulated private-sector development by making investment opportunities available, spurring capital market development, and contributing to a more competitive business environment.

The above can at best be considered as hypotheses, which need to be empirically verified in the context of a comprehensive study of the economic and social impact of privatisation in Africa. Other issues, including the role of

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ownership in enterprise efficiency, will also be empirically investigated, using rigorous analytical techniques; unlike the few existing studies, which are highly qualitative.

Table 2: Summary of Privatisation of Public Enterprises in Africa (to End 2002)

Country/Region	Total Number of Transactions	Total Sales Value (US$m)
Sub-Saharan Africa	3,486	6,686
Excluding South Africa	3,475	4,477
Excl. S. Africa & Nigeria	3,394	4,270
Angola	57	n.a
Benin	57	63
Botswana		
Burkina Faso	31	9
Burundi	46	12
Cameroon	58	72
Cape Verde	70	172
Central African Republic	52	n.a
Chad	44	6
Comoros		
Congo, Dem. Rep. of	21	n.a
Congo, Rep. of	105	50
Côte d'Ivoire	134	810
Djibouti		
Equatorial Guinea		
Eritrea		
Ethiopia	164	n.a
Gabon	29	n.a
Gambia, The	39	10
Ghana	233	667
Guinea	122	9
Guinea-Bissau	58	1
Kenya	188	248
Lesotho	24	128

To be continued

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Table 2: Continued

Country/Region	Total Number of Transactions	Total Sales Value (US$m)
Liberia		
Madagascar	138	43
Malawi	91	57
Mali	87	32
Mauritania	56	10
Mauritius		
Mozambique	579	217
Namibia		
Niger	41	3
Nigeria	81	207
Rwanda	21	n.a
Sao Tomé and Principe	9	n.a
Senegal	71	326
Seychelles		
Sierra Leone	9	n.a
Somalia		
South Africa	11	2,209
Sudan	32	n.a
Swaziland		
Tanzania	283	246
Togo	78	39
Uganda	108	198
Zambia	253	686
Zimbabwe	6	156
North Africa	186	595
Algeria		
Egypt, Arab Rep.	59	307
Libya		
Morocco	64	259
Tunisia	63	29
All Africa	**2,326**	**5,619**

Note: n.a – Not available

Source: World Bank African Development Indicators, 2004.

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Table 3: Privatisation record in Africa, 1991-2001

Country	Number of Transactions	Sale Value (USS millions)	Share of Total Divested (%)
Angola	57	6.0	-
Benin	28	49.0	38
Burkina Faso	23	9.0	32
Burundi	8	4.0	-
Cameroon	48	244.0	28
Cape Verde	42	53.0	-
Central African Republic	18	-	50
Chad	35	12.0	-
Congo, Rep. of	65	50.0	-
Congo, Dem. Rep. of	5	-	4
Côte d'Ivoire	82	622.0	55
Ethiopia	10	4100	6
Gabon	1	-	6
Gambia	17	2.4	85
Ghana	181	936.5	69
Guinea	31	45.0	27
Guinea Bissau	25	0.5	64
Kenya	189	381.0	79
Lesotho	10	6.5	20
Madagascar	61	16.9	33
Malawi	11	53.2	44
Mali	59	67.4	92
Mauritania	19	1.2	20
Mozambique	474	1,350	39
Niger	10	1.8	18
Nigeria	30	893.5	6
Rwanda	1	-	3
Sao Tomé & Principe	4	0.4	-
Senegal	39	415.0	23
Sierra Leone	8	1.6	31
South Africa	8	3,151.0	-
Sudan	32	-	-
Tanzania	199	287.0	53
Togo	49	38.0	89
Uganda	102	174.0	79
Zambia	253	828.0	90
Zimbabwe	6	217.0	10
Total	**2,240**	**9,111.9**	**40**

Source: Economic Commission for Africa, Report on Africa, 2003.

Chapter 8

Impact of Privatisation: Theoretical Predictions

The privatisation of public enterprises is expected to lead to a number of effects: macroeconomic effects, microeconomic or efficiency effects and social effects.

Macroeconomic Effects

The macroeconomic effects relate to expected improvements in economic growth, the fiscal position of the government and investment. Privatisation, it is argued, increases (the private sector and hence) economic growth. But as Dijk and Nordholt (1994) have observed, despite the plausibility of this hypothesis, the theoretical underpinnings are quite complicated, more especially in view of the various factors which determine economic growth: technological development, investment, education, innovation, etc. Nevertheless, the expectation is that privatisation will benefit economic growth by raising the return to private capital accumulation. Growth could, however, be damaged by it, if economic efficiency is not increased or if the quality of human capital is adversely affected (Parker and Kirkpatrick 2005: 528). With respect to investment, a pertinent question relates to whether a privatised company will invest more than a public company. Against the perception that in the public sector, investments are often crowded out by expenditure for consumption purposes, and against the background of an underdeveloped capital market that is characterised by a shortage of funds, if private individuals invest in the purchase of a government enterprise, it will occur at the expense of private consumption, which can promote growth, or at the expense of other private investment (Dijk and Nordholt 1994). But as Jones, *et al* (1990) in Boorsma (1994: 25) observes, it is possible that these sales can appeal so much to the market that the interest rate increases, which leads to a decrease in investment. Also, privatisation could lead to a reduction in

investment to the extent that the authorities initially nationalised, or founded PEs as a means of stimulating investment in domestic productive capacity. It is also possible that PEs were able to borrow at subsidised interest rates, either explicitly or via implicit government guarantees, in which event their investment levels could exceed those of private firms. Nevertheless, it is felt that privatisation should stimulate investment in so far as the management of PEs had been associated with significant episodes of decapitalisation. And the expectation is that a higher rate of economic growth should result from an increase in investment. Furthermore, in relation to efficiency arguments, it is felt that a privatisation programme that enhances a firm's operational efficiency and improves resource allocation may produce long-term benefits such as higher corporate earnings, increased employment and more rapid economic growth (Boardman and Vining 1989; Kikeri, Nellis and Shirely 1992). However, Davis, *et al* (2000) finds no strong relationship between privatisation and investment, and in the case studies analysed, the authors could not attribute the growth in investment solely to privatisation.

And on the broader issue of the impact of privatisation on economic growth, a few studies have addressed the question of whether economies with higher levels of privatisation achieve higher rates of economic growth, and they provide mixed results. The analysis of Cook and Uchida (2002) does not support a positive effect of privatisation on growth. Similarly, Yoder, *et al* (1991) finds no significant correlation between privatisation and various development indicators. But Plane (1997) and Barnett (2000) provide evidence to show that privatisation leads to higher economic growth. Similarly, Taiwo (1989), in a single-country study of the potential effects of privatisation on Nigeria's economic growth, finds that private investment has a greater influence on GDP than public investment and, hence, concludes that privatisation has the potential of enhancing economic growth. This is actually not a study of the direct impact of privatisation on economic growth, as privatisation had barely started in the country when the study was published. Rather, the time series study indicates the relative significance of private and public sector investments. Sub-Saharan African countries expect privatisation to impact positively on their long-term growths. This will, therefore, be an interesting issue to address in an impact study of privatisation on African economies: Does privatisation result in higher growth rates in Africa? This issue has not been addressed directly by the existing few studies on privatisation in Africa.

It is felt that one of the strongest drives for PEs' reform and/or privatisation in the developing countries is unpleasant budget realities, in terms of fiscal deficits and large debts, and the consequent expectation of alleviation of PE

budgetary burden on the government, and overall improvement in the fiscal position/public finance (Heald 1990; Adam, *et al* 1992; Lesser 1991; Cook and Kirkpatrick 1991; White and Bathia 1998; Van de Walle 1989; Bienen and Waterbury 1989, etc.). The fiscal argument maintains that divestiture will cut government expenditure and help to restore budgetary balance (Van de Walle 1989: 603). Privatisation should improve a government's financial flows by raising one-off revenue from the sale of assets and shares, by reducing the need for operating subsidies and investment capital (which become the responsibility of the new owners and managers), and by increasing tax revenues as a result of improved enterprise performance (White and Bathia 1998: 78; Makalolou 1999: 10). And Heald (1990: 8) observes that privatisation is relevant to the budget in the following ways:

- if privatisation led to greater efficiency and/or lower financial losses, there might be a reduced call on the budget for subventions;
- privatisation of industrial enterprises might lead to elimination of macroeconomic capacity and by distancing the government from the adjustment process, eliminate its legal obligation to make up losses and otherwise limit its exposure; and
- by privatising an enterprise like telecommunications, the business would no longer look to government for its financing needs, and thus eliminate a claim on the budget.

And Commander and Killick (1988) observe that the link between privatisation and the balance of payments is through the budget. With PEs being large-scale claimants of budgetary subsidies of various kinds (and also representing an unutilised part of the tax base), divestiture is often seen as an important way of reducing the government budget deficit, with all its implications for inflation and the balance of payments. However, Mansoor (1988) suggests that the budgetary effects will be keenly affected by the extent to which divestiture results in increased competition.

Moreover, various analyses suggest that, theoretically, the impact of privatisation on public finances is ambiguous or neutral or negligible (see for example, Van de Walle 1989; Cook and Kirkpatrick 1988; Adam, *et al* 1992; Mansoor 1988; Hemming and Mansoor 1988a, etc.). The argument is that in the simplest, ideal-world theoretical case, a PE's sale price should be exactly equivalent to the discounted stream of expected profit remittances the state would have received if the PE had remained in the public sector, as long as it assumed that the private and public sectors face the same tax liabilities and perform at the same

productivity levels. If this is the case, then only the composition of assets changes, but their level does not; the fiscal impact of privatisation, strictly speaking, is nil. This is the neutrality result (Adam, *et al* 1992) and is useful to demonstrate that the sale of the asset itself does not necessarily generate any real effect. Rather, real effects emerging from privatisation can be seen as deviating from this neutrality position. The simple theoretical case is useful in pointing out that many of the alleged gains are illusory, and reflect the substitution of present for future government consumption. It is important to note that the theoretical case applies whether or not the PE is profitable; in the more interesting case the PE loses money and the state then has to pay the buyer the discounted value of the PE's foreseeable losses. In this case, the government offers a lump-sum subsidy to the buyer in order to sell it, and this entails higher interest payments to service the debt incurred to finance the subsidy which would offset lower transfers to the enterprise (Mansoor 1988b). The change of ownership of loss-making enterprises may, therefore, have an insignificant impact. Nevertheless, in practice, some factors suggest that privatisation may have a real impact. For example, different assets are not perfect substitutes and liquid assets may be more useful to the government than equity. If this is the case, privatisation has a real fiscal impact. Furthermore, if the private sector is expected to run the firm more efficiently, that expectation will be reflected in a higher sale price, which will then further exceed the PE's discounted income stream. Besides, it is argued that with the profit stream that can be extracted from the privatised asset in the hands of private owners higher than if operated under public ownership, privatisation will increase total factor productivity in the economy. Thus, its real public finance impact arises out of the additional tax revenues generated from the enhanced value of the asset realised under private ownership.

Microeconomic Effects

At the microeconomic or firm level, the proponents of privatisation are confident that gains in economic efficiency (productive and allocative efficiency) will be much higher in a privatised firm than if it were under public ownership for the following reasons (Dijk and Nordholt 1994; Van de Walle 1989; Cook and Kirkpatrick 1988; Adam, *et al* 1992, etc.):

(i) the motivation of the manager in the private sector is directed at efficiency and profit, contrary to the motivation of the manager in the public sector. The property rights school argues that in the classical small firm where ownership and management coincide, the manager-owner has a direct interest in minimising costs, since reward is directly related to performance (Furubotn and Pejovich 1972). In the large corporate enterprise

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where ownership and management are separated and the owners of the property rights may have limited control over management, the possibilities of any non-profit maximising activities of managers are constrained by the potential sanction of take-over, which is the primary means by which the capital market can exert pressure on the private firm to maximise profit (Cook and Kirkpatrick 1988: 13). On the other hand, the school contends that managerial incentives to maximise profits and minimise costs are undermined by public ownership (Demstez 1968; Furubotn and Pejovich 1972); public managers are given numerous and inconsistent objectives by government supervisors. And unwieldy bureaucratic controls, and the absence of shareholders with a direct interest in profits, lessen the pressure on managers to maximise company performance;

(ii) that public enterprises often have monopolies and lack the incentive for competition. And if this is the case, the PE will fail to achieve allocative efficiency. Allocative efficiency, in welfare economics, arises from the marginal equivalence conditions, which ensure that consumer's needs are met at prices that reflect the cost of provision. If markets are competitive, the forces of competition ensure that allocative efficiency is achieved. It means, therefore, that allocative efficiency will not be achieved where privatisation results in the transfer of ownership from a public monopoly to a private monopoly (Dijk and Nordholt 1994). In the absence of competitive market forces, an adequate or appropriate private sector "supply response" may not be forthcoming, and the viability and performance of the privatised enterprise may be endangered (Nellis and Kikeri 1989). And to Stiglitz (1999), the theorems establishing the efficiency of markets require both private property and competitive markets. Converting a public monopoly into a private monopoly may actually lead to higher, not lower, prices and less, not more, overall economic efficiency. Besides, Adam, *et al* 1992, conclude that 'privatisation in smaller developing economies cannot be analysed within the simple property-rights and contestability paradigms. Changing ownership itself will not be sufficient, and may not even be necessary to elicit performance improvements. Rather, competition and regulation policy will emerge as major determinants of the effects that privatisation will have on economic efficiency'; and

(iii) that the public enterprise is at a scale which is determined by the public sector. But a private enterprise chooses a scale, which is determined by market forces to benefit from economies of scale.

Thus, taking the arguments in totality, the expectation is that post-privatisation firm-level performance should improve in terms of profitability, output, operating efficiency, capital expenditure and leverage. The privatised firm is expected to revel in the benefits of new investment, new technology and improved corporate governance. Nevertheless, concerns have been expressed that whether in competitive or imperfect markets, gains in allocative efficiency are likely to be modest (Van de Walle 1989; Hemming and Mansoor 1988). The efficiency gains are, however, important empirical issues that research on the impact of privatisation in Africa can shed light on. Interesting issues relate to the macroeconomic and microeconomic effects of privatisation. What are the effects of privatisation on government finances and wealth? What are the other macroeconomic effects, for example, on investment and growth? What are the effects of privatisation on the capital market and foreign private investment inflow? What about the contentious issue of ownership? Is privatisation related to performance or efficiency? Are privatised firms more efficient than public enterprises? In other words, does ownership matter in the performance of privatised enterprises? A related issue that would need to be explored empirically concerns the relationship between management incentives and privatised enterprise performance. Many models of state and private ownership predict that privatisation will link the management compensation more directly to financial performance (Cragg and Dyck 1999). In a number of models, enhanced incentives is the primary channel through which privatisation improves performance. In their analysis of privatisation, compensation and management incentives in the United Kingdom, Cragg and Dyck (1999) find that prior to privatisation, compensation in SOEs was unrelated to changes in financial performance. In contrast, in privatised firms, compensation is sensitive to changes in a firm's financial performance while management option and shareholding serve to tie ever-greater portions of management wealth to changes in shareholder value. Essentially, ownership change provides increased compensation and incentives tied to financial performance. Thus, in the Sub-Saharan African privatisation context, the interesting research questions would be: does privatisation work/increase financial performance by enhancing management incentives? How sizable are the differences between state and private ownership?

Social and Distributional Effects

Perhaps, because of the ideological fervour with which the debate on privatisation has often been conducted by its advocates, they hardly attach any significance to the distributional and poverty concerns of privatisation. Yet, privatisation rarely has a neutral effect on the distribution of income and poverty

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(Adam, *et al* 1992; Obadan, Jerome and Agba 2001; Parker and Kirkpatrick 2005; Van de Walle 1989; Martin 1993; Commander and Killick 1988; Berg 1988; etc.). The positive effects of privatisation on the budget deficit and on economic efficiency are not felt until the medium-term (Obadan, Jerome and Agba 2001; Bouin and Michalet, 1991). But the negative social effects become visible right from the short term, although in the ideological climate in which privatisation is carried out, there is often a tendency to underestimate the negative distributional consequences. These consequences are felt in the spheres of income and wealth distribution, employment, wages and real income, and poverty. There are *a priori* reasons to believe that privatisation will result in greater inequities or increases in poverty (Van de Walle 1989). But as Parker and Kirkpatrick (2005) correctly observe, the impact of privatisation on poverty reduction and income distribution is unpredictable. It is so in the case of poverty because privatisation may help reduce poverty by increasing incomes and expanding services, while at the same time increasing poverty through higher prices and reduced employment and tax payments. Kikeri (1998) argues that privatisation can lead to fewer jobs, but it may lead to better or worst paid ones. Again, the welfare outcome is not certain. Bouin and Michalet (1991) conclude along the same lines from their analysis of two circumstances which they believe to be fairly unlikely eventualities, particularly bearing in mind the other means of redistribution at the state's disposal. The circumstances, which can make privatisation have negative social results, are:

- if, following from privatisation, the state abandons the social objectives previously pursued and does not seek to replace the PE by another form of redistribution; and
- if the supply of certain goods by the public sector was the most effective solution for reaching the underprivileged classes.

The efficiency argument for privatisation stresses the potential benefits to consumers from lower cost of production. If consumers benefit from a reduction in the price of the good or service for sale, then an increase in their real income would result. The distributional effect will depend on the income classes from which these consumers are drawn. But because PEs have been used by governments as a means of subsidizing consumers, for example, for wage goods or the delivery of economic services, the substitution of market-determined prices for the previously subsidised prices will create a group of unambiguous losers, which may or may not be made up of poverty groups, because of the inefficiencies of state subsidies (Commander and Killick 1988). Thus, privatisation may

contribute to economic efficiency. But it does not lead to the equitable distribution of the surplus generated, and who appropriates the surplus depends, along the lines of microeconomic theory, on the degree of competition to which the enterprise in question is subject. A number of possible outcomes are as follows:

- if the privatised firm retains considerable monopoly power, then the benefits will be retained in whole or in part by the owners of capital and there will be at least a short- term shift in functional distribution of income in favour of capital, tending to increase inequalities in size distribution; and
- if privatisation results in a sustained shift in the functional distribution of income in favour of owners of capital, this itself will tend to aggravate wealth inequalities, as streams of income from profits are converted into assets.

However, where widespread and highly fragmented sale of shares in privatised enterprises exist, it may have actually reduced the skewness of wealth ownership. But if ownership remains in the hands of already wealthy elite, inequalities in income distribution will equally be perpetuated. And if ownership passes into foreign hands, the effect will be to widen international inequalities in the distribution of wealth, with associated income streams increasing the gap between domestic and national income (Commander and Killick 1988).

Privatisation generally has negative effects on employment, although references are also made to the possibilities of increased employment. Dijk and Nordholt (1994: 30) observe that if privatisation leads to an increase in the quality of the goods and services provided, then the sales of the enterprise could grow and hence employment. Increased employment can also result if privatisation reinforces technological development, stimulates investment and increases economic growth. In the same vein, Hachette and Luders (1993), against the background of the impact of privatisation in Chile, report that empirical analysis shows that change of ownership associated with privatisation does not affect employment levels per se, but that the drive to increase efficiency levels, of which privatisation might be a tool, does. Employment rationalisation tends to reduce employment to its optimum level. Bishop and Kay (1989) confirm the negative impact of the U.K privatisation on employment. According to them, employment fell substantially across the 1979 public sector, although outputs and profits increased. In Zambia, in the non-mining firms, employment declined from 28,000 at the time of privatisation to 20,000 in 2001, or by 29 per cent, while employment in the mining sector decreased by at least 7,000 workers or 20 per cent (Nellis 2003: 18).

Many others believe that significant unemployment could result in certain situations as redundant workers are laid-off (Bouin and Michalet, 1991; Berg 1988; Commander and Killick 1988; Walle 1989, etc.). Public enterprises are often blamed for tolerating over-staffing and higher wages than are accorded in the private sector, or would obtain under market conditions. And the influences of trade unions tend to be stronger in PEs and they are usually opposed to divestiture for reasons such as:

- certainty that privatisation will lead inevitably to massive staff lay-offs and fall in wages;
- fear that workers' benefits in employment rights and pension schemes will be called into question;
- difficulty of finding alternative employment in urban areas already largely affected by unemployment; and
- lack of unemployment benefit schemes and the precarious situations of the employees laid-off.

In practice, the short-run effect of divestiture is to reduce the size of the workforces, as restructuring and modernisation of the privatised firm are undertaken in order to reduce production costs. And unemployment, as one of the social costs of privatisation, can be very severe in the short run, particularly in countries with high rates of unemployment and under-employment. Where consumers benefit from a reduction of the price of the goods/service produced resulting from wage costs reduction, it only implies a transfer of income from former employees of the public firm to the consumers of the good produced.

Privatisation measures hurt the poor in many ways (see for example, Walle, 1989; Obadan, Jerome and Agba 2001; Bouin and Michalet, 1991). Privatisation may affect the poor if the goods and services provided by the PE become less accessible to them. The provision of certain services, especially in the rural or disadvantaged areas, is potentially affected by privatisation. The adoption of private sector rationality gives rise to the concern about deterioration in the coverage of service or in its quality. This may happen where, for example, transport firms stop operating little-used routes or banking services are withdrawn from rural areas. Also, prices often rise as a result of reforms, and frequently adversely affect low-income groups more than others, either in absolute or relative terms. Generally, an increase in the price of a good or service results in a loss of consumer surplus for the consumers. And a rise in the prices of essential goods entails a reduction in income for the poorest, since the elasticity of their

demand compared to the price is nil (Bouin and Michalet, 1991). In the case of other goods and services, the elimination of subsidies and significant rise in prices may simply eliminate the demand of certain social classes of consumers for such goods. In this case, the social impact of privatisation seems very negative. Attention has been drawn to the major problems in assessing the social impact of privatisation (Cook and Kirkpatrick 1988; Bouin and Michalet 1991). This appears to account for the relative scarcity of studies on the subject in the developing countries (OECD 2004: 13). Nevertheless, Birdsall and Nellis (2002) conclude that most privatisation programmes appear to have worsened distribution, at least in the short run. This is more evident in the transition economies than in Latin America. It will be interesting to know what research on the social/distributional impact of privatisation in Sub-Saharan Africa will show. The specific questions of interest include: what is the effect of privatisation on the distribution of income and wealth? What is the effect on poverty? What is the social impact of privatisation on consumers and employees? How is household welfare affected? Does privatisation reduce or increase employment? Is the possibility of unemployment anticipated and policies put in place on retrenchment and related benefits?

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Chapter 9

Impact of Privatisation: Empirical Evidence

Before presenting the findings of key empirical analyses of the impact of privatisation, the methodological difficulties in the assessments are first explained. This is followed by a review of the various approaches for the impact assessment.

Methodological Problems

The literature reveals that attempts to assess the impact of privatisation and draw more rigorous and general quantitative conclusions are beset with a number of methodological problems (Adam, *et al* 1992; Parker and Kirkpatrick 2005; Perevalov, *et al* 1999; Martin and Parker 1997; Fine 2005).

These problems include the following:

a) Data availability and measurement. This is the first problem facing any research into privatisation. The poor financial and technological data facing SOEs prior to privatisation make evaluating changes consequent on the transfer of ownership difficult (Adam, et al, *op.cit*: 515). Even when the data are available, it may not be possible to draw any firm conclusions because of the time lags involved in the assessment of changes in performance.

b) To assess the effect of a policy change such as privatisation, counterfactuals are needed, in terms of what would have happened in the absence of privatisation. This is obviously problematic. It is usually very uncertain knowing what would have happened to an economy or industry in the absence of privatisation (Martin and Parker 1997). Matters are more complex in the case of monopolies, and in particular the natural monopolies where there is, by definition, no counterfactual comparator.

c) The variables to measure when assessing performance may not be obvious. Privatisation may be found to have improved performance, or not,

depending upon the objective of the privatisation and the performance measure used. For example, measuring changes in profitability will tend to flatter privatisation if under state ownership non-profit goals were deliberately pursued, for example, higher employment or lower prices (Parker and Kirkpatrick 2005). Thus, as was noted earlier, where empirical research compares profit-based performance indicators, which is often the case, the public sector is being judged by the criteria of the private sector.

d) Privatisation can be expected to have both microeconomic and macroeconomic effects, for example, the generation of relative price changes affecting both output and input markets with spill-overs into other sectors of the economy. But a general equilibrium model, which ideally should be used to assess privatisation in this case, is highly complex and requires data that usually are not available to the researcher.

e) Determining causality is an important issue in empirical work. But where the relationship between performance and policy is unclear, it is difficult to assess the impact of privatisation programmes. Performance may change because of other economic events (policy, institutional and structural) occurring at the same time with privatisation. Identifying the precise separate effects of privatisation then becomes problematic in the absence of necessary independent data and flexibility (Parker and Kirkpatrick 2005). In particular, most privatisation programmes in the developing world have been implemented in the context of wider economic reform programmes entailing deregulation, liberalisation and other macroeconomic policies. It can be very difficult to separate the effect of privatisation from these other policies that are often implemented simultaneously.

f) Problem of selection bias in any form of comparative analysis (Perevalov, *et al* 1999; Adam, *et al* 1992). For example, if as is the case, governments embark on their privatisation programme by selling the most viable enterprises, the resulting performance effects may be overstated *vis-a-vis* the impact of privatisation on the SOE sector in total. And as Perevalov, *et al* put it 'if performance results of an enterprise determine the decision to privatise it, then the assumption that privatisation affects performance leads to a misinterpretation of the relation and to incorrect privatisation decisions.' In the same way, most empirical studies tend to suffer from selection bias since they only include successful private or successfully privatised firms as opposed to the failed and those not privatised. Also, analysis typically relies on the cooperation of firms that have been privatised, and firms that perform better tend to be happiest to participate

while others that have been less successful may be less keen to share performance data (Fine 2005: 9).

g) Finally, a more fundamental problem derives from the fact that standard economic theory, in general, has nothing to say on ownership *per se*. It offers no clearly defined and testable hypotheses, but rather establishes the link between ownership and performance through a series of related theories and hypotheses concerning the nature of incentives, agency problems, financial constraints and profit-maximising behaviour. Inference is, therefore, necessarily complicated, and there is no necessary connection between economic theory and ownership (Commander and Killick 1988).

Notwithstanding the above problems and difficulties, a plethora of empirical studies of the impact of privatisation have appeared in the last one and a half decades. The extent of their reliability is, however, another issue. And not only is the literature heavy on description, but Fine (2005: a) considers it more or less arbitrary statistical exercises.

Methods of Impact Assessment

A number of approaches have been used to evaluate the impact of privatisation. They range from the 'synchronic' approach and 'historical' approach (Frydman, *et al* 1997) to case studies of a small sample of firms and multi-country studies or country-specific studies, much of it, inspired by Megginson, *et al* (1994), and to panel data methodology and econometric analysis. The synchronic approach is based on a comparison of performance of state and private (or privatised) firms (Boardman and Vining 1989; La Porta and Lopez-de-Silanes 1997; Commander, *et al* 1996; Dewenter and Malatesta 1998, etc.). Here, it is supposed that the compared firms work under the same conditions: at the same time, in the same markets, within the same environment. But it is practically impossible to find two identical enterprises, for example, in the same industry. Thus, it seems more reasonable to compare the *ex-ante* and *ex-post* performance of the same enterprise, as the historical approach does, and as used by Megginson, *et al* 1994; Dewenter and Malatesta 1998; Frydman 1997, etc. The approach, which is straightforward, permits only measuring the enterprise performance changes after privatisation, but fails to isolate the privatisation benefits from the impact of other factors that would also have influenced the performance results (Perevalov, *et al* 1999). A combination of the two approaches could, however, eliminate the possibility of selection bias (Frydman 1997).

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The case studies are usually more comprehensive taking advantage of consistent data set. They usually provide a rich source of descriptive data and more readily address qualitative as well as quantitative effects. They can identify specific responses that may be lost in the aggregation that goes into econometric analysis. But case studies have their own limitations relating to both the collection of information and the interpretation of events (Parker and Kirkpatrick 2005). They also often detach from explicit theory and are inductive in nature. Multi-country and inter-industry comparisons, on the other hand, settle on data that is universally available.

The other major method of assessing privatisation impact relates to econometric studies and panel data methodology. These use statistical data to undertake an assessment of the effects of ownership on performance variables, for example, profitability, productivity, costs of production and financial ratios, while controlling for a host of characteristics of the firm or industry or country. Typically, an attempt is made to model the relationship between dependent and independent variables with a view to measuring the separate effects of each independent variable, where the dependent variable is some measure of economic performance and ownership is one of the explanatory variables alongside variables relating to outputs, inputs and "controls" (Adam, *et al* 1992; Parker and Kirkpatrick, 2005). The standard model is of the form:

$$P = a_0 + a_1 N + a_2 X + e$$

Where P is the measure of performance; N is the ownership variable; and X is a vector of other explanatory variables, reflecting relevant characteristics, both the nature of the firm and the macroeconomic and policy environment in which it operates. The focus of the work is, essentially, to estimate the size and sign of the coefficient a_1.

Often, the above model is estimated with panel data-time series cross-sectional data. With panel data, one can model the heterogeneity across groups or units, which is typical in microeconomic data. Thus, panel data estimation is considered as the most suitable method of capturing the variation over time of firm performance indicators because it can control for individual, firm-specific heterogeneity, as well as for temporal changes in firms' operating environment (Bortolotti, *et al* 2001). The usual case in panel data analysis is to estimate both a fixed effect and a random effect model (Green 1995). The fixed effect specification assumes that enterprises/firms constitute a random sample. But as Green (1995) observes, the relevant distinction between the two models is not whether the effect is fixed or not. Rather, it is whether the effect is correlated with the explanatory variables. Consequently, the procedure is to first test whether

individual effects exist and, if so, to identify which is the best model to estimate them (Obadan and Jerome 2004; Perevalov 1999).

Commenting on the economic approach, Parker and Kirkpatrick 2005 op. cit., observe, that if carried out correctly, econometric studies of the impact of privatisation avoid erroneous correlations and replace casually associated and unquantified cause and effect relationships with more precise measurement. But that econometric analysis is dependent on adequate data both in terms of quantity and quality to carry out the necessary estimation and each estimation model is subject to its own set of limitations, in particular, spurious results where models are miss-specified.

Empirical Findings

The phenomenal increase in the number of privatisation programmes across the globe has generated a lot of research interest in the last one and a half decades. Accordingly, there have been several studies of, and publications on, privatisation and economic performance, particularly the relationship between ownership and efficiency. Much of the empirical assessments has a micro-economic orientation and inspired by Megginson, *et al* (1994). Hardly have any of the studies relating to the developing countries looked directly at the impact of privatisation on economic development and poverty reduction (Parker and Kirkpatrick 2005). This is perhaps due to the assumption that a more efficient use of resources must contribute to raising economic growth and, in time, reducing poverty. The vast numbers of articles and studies on the subject have been surveyed at different times (for example, Vickers and Yarrow 1988; Bouin and Michalet 1991; Millward 1988; Kirkpatrick, *et al* 1994; Shirely and Waish 2000; and more recently, Megginson and Netter 2001; Nellis 2003; and Parker and Kirkpatrick 2005). The major findings of the surveys will be outlined along with a few other main results. The studies have generally taken the form of firm-level or case studies of a small sample of firms, sectoral studies and country-specific or multi-country studies.

Kikeri, *et al* (1994) observe that the 1970s and the early 1980s witnessed an outpouring of articles and studies comparing the efficiency of similar types of production or service under private or public ownership (e.g. Borcherding, Pommerehne and Scheider 1982; Domberger and Piggott 1986; Yarrow 1988). Most of the cases were drawn from industrial countries and focused on municipal services, airlines and other transport services, electric utilities, insurance, hospitals and housing. The studies were partial, in that they concentrated mostly on costs. Most found that private production was cheaper than public, but they tended to conclude, as one study put it, that 'it is not so much the difference in ... ownership but the lack of competition which leads to the often observed less efficient production in public firms.' And a survey of the scanty material from

cases in the developing countries offered a guarded conclusion (Millward 1988): 'there is no evidence of a statistically significant kind to suggest that public enterprises in LDCs have a lower level of technical efficiency than private firms operating at the same scale of operation. (But) on a less formal level, the tendency ... seems to be pointing in that direction.' Thus, those studies, up till the 1980s, in industrial economies largely attributed superior efficiency in private over public firms to market structure rather than to ownership, while the few studies of developing countries revealed marginal efficiency differences between public and private firms (Kikeri, *et al* 1994). Adam, *et al* (1992) concludes from their review of empirical studies up to the 1980s that the empirical evidence on the effect of ownership is less than categorical. That, *ceteris paribus*, in relatively competitive markets the evidence suggests that private enterprise is rarely (if ever) less efficient or less profitable than comparable public enterprise. But beyond this conclusion the results are less clear, although this ambiguity serves to underline the central argument that ownership by itself is rarely the dominant determinant of performance. In particular, according to the authors, the influence of the regulatory and competitive environment (particularly in the utilities sectors) greatly overrides the impact of ownership on enterprise performance. In their comprehensive study of the economic impact of privatisation in Chile in the early 1990s, Hachette and Luders (1993) posed the question: does privatisation lead to more efficient enterprise? Their answer is this: 'the economic results obtained do not allow a definite reply one way or the other. Data gathered from financial ratios or balance sheets and income statements suggest that private-sector enterprises are somewhat more profitable than state-owned enterprises, but the differences, although statistically significant, are small. This result does not confirm the majority expert opinion and, to a certain extent, inferences that can be made from economic theory.'

However, several assertions have been made that more recent evidence, which compares SOE performance before and after privatisation, shows considerable economic benefits from privatisation (Kikeri, *et al* 1994; Perevalov 1999; Megginson and Netter 2001; Boubakri and Cosset 1998; IMF/Havrylyshyn and Mc Gettigan 1998, etc.). Indeed, summing up their survey of the empirical record on the financial and operating results of privatisations around the world, Megginson and Netter are reported to have stated unequivocally (see Nellis, 1999):

'... the evidence is now conclusive that privately owned firms outperform SOEs... empirical evidence clearly shows that privatisation significantly (often dramatically) improves the operating and financial performance of divested firms.' Nellis (1999: 2) concludes, 'the fact is that almost every rigorous study

comparing pre-and post-privatisation operation indicates, on average, sizable performance improvement.'

The empirical findings in Tables 4a-4e provide some insights into the economic impact of privatisation, but hardly on the distributional and poverty elements of the social impact. Employment is reported to have increased in some cases after privatisation while it reduced significantly in others. While the evidence is broadly favourable to privatisation, in terms of some discernible positive effect on the financial performance of companies, it is hardly conclusive,

Table 4a: Summary of Empirical Findings on Privatisation

Study	Nature of Study	Empirical Findings
Galal, *et al*, (1994)	. A comparison of the performance of 12 large firms, mostly airlines and regulated utilities, in Chile, Malaysia and Mexico (developing countries) and the UK. . Sought to explore both the changes in economic efficiency and welfare effects of privatisation	. Net welfare gains in 11 of the 12 cases (except Mexican airlines), on average equalling 26% of each firm's pre-divestiture sales. . Welfare gain obtained without negative welfare effects on employees.
Megginson, *et al* (1994)	Compare the pre-and post- privatisation financial and operating performance of 61 firms in 32 industries in 18 countries between 1961 and 1990	.Privatisation is associated with higher profitability, more efficiency, larger sales and more capital investment
D'Souza and Megginson (1999)	. Complementary to Megginson, *et al.* . A study of the pre-and post-privatisation performance of 85 firms in 28 countries, between 1990 and 1996.	. Higher mean levels of profitability, real sales and operating efficiency, significant reductions in leverage ratios, and insignificant changes in employment and capital spending post-privatisation. . Profitability increase is more in regulated non-competitive industries, but operational efficiency increase is less in those industries
Dewenter and Malatesta (2001)	. Adopts a similar method to that used by Megginson, *et al*, and D'Souza & Megginson.. Covers 63 privatised firms between 1981 and 1994..	. Profitability and productivity increased, considering return on sales and assets. But profitability measured as earnings before interest and tax as a ratio of sales and assets declined. This underlines the sensibility of the results to the performance measure used.
Martin and Parker (1997)	. Assessment of the impact of privatisation on 11 major privatised firms in the UK between 1981 and 1988	. Mixed results for privatisation. .While some of the enterprises recorded increased productivity growth after privatisation, the results were not positive in other cases. Same pattern with other performance measures.

Source: Compiled from Parker and Kirkpatrick (2005); Obadan and Jerome (ed.) (2004), and individual empirical studies.

Table 4b: Summary of Empirical Findings on Privatisation

Study	Nature of Study	Empirical Findings
Boubakri and Cosset (1998)	. Examine the financial and operating performance of 79 firms involved in privatisation in 21 developing economies (mainly middle-income countries) in theperiod, 1980 1992.	. Significant improvements in profitability, operating efficiency, capital investment, output, total employment and dividends. . Decline in leverage. . Number and degree of success of privatisation is significantly associated with a country's level of income. The lower the income, the more likely it will be that the results will be modest
Eckel, Eckel and Singal (1997)	. Examine the effect of British Airways (BA) 1987 privatisation on the stock prices of competitors and on fares charged in those routes where BA competes directly with foreign airlines.	. Stock prices of rival firms fall significantly following announcement of privatisation. . Air fares in international routes served by BA fall by 14.3% relative to those on other transatlantic routes. . Fall in fares is accompanied by lower costs of operations after privatisation.
Rama-murti (1997)	. A descriptive study which examines the impact of the 1990 restructuring and privatisation of the Argentine railroads-Ferrocarilla Argentinos.	. 370% improvement in labour productivity. Decline in operating subsidies almost to zero. . Massive decline in employment from 92,000 to 18, 682 workers (79.7%). . Expanded and improved services delivered at lower cost to consumers.
Claessens and Djankov (1999)	. Examine ownership concentration and corporate performance in 706 Czeck firms privatised through the voucher method from 1992-97.	. Profitability and productivity changes are positively related to ownership concentration. A 10% increase in concentration leads to a 2% increase in labour productivity and a 3% increase in profitability. . Results are weakly robust to alternative econometric and data specifications.
Anderson, Lee and Murell (2000)	. Assess the effect of competition and ownership on the performance of 211 newly privatised firms in Mongolia	. Competition exerts a decisive effect on performance. . Enterprises with residual state ownership perform better than private ownership.
La Porta and Lopez-de-Silanes (1997)	. Analysis of the performance of 218 enterprises, in 26 sectors, privatised in Mexico from 1982 to 1991, using a number of broad indicators	. Remarkable increases in profitability and output after privatisation, underpinned by higher efficiency as reflected by: - Substantial decreases in unit costs and a 24% increase in the ratio of operating income to sales. - Significant decrease in employment levels.
Sachs, Zinnes & Eilat (2000)	. A large-scale privatisation study with a macroeconomic orientation. Using a panel of 24 transition economies, the study examines if a change in title (privatisation) alone is enough to guarantee the gains associated with privatisation	. Results indicate that the level of reforms contributes to recovery, but change in title alone is not sufficient to generate economic performance gains. . Real gains from privatisation come from combining change of title/ reforms with other structural reforms including institutions.

Source: Compiled from Parker and Kirkpatrick (2005); Obadan and Jerome (ed.) (2004), and individual empirical studies.

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Table 4c: Summary of Empirical Findings on Privatisation

Study	Nature of Study	Empirical Findings
Ros (1999)	. Examines the performance of telecommunications firms in 110 developed and developing countries between 1986 and 1995 using a fixed effects panel data model.	. Results suggest that where there is at least 50% private ownership in the main telecom firm, teledensity levels and output growth rates significantly improved. . While privatisation and competition both raise efficiency, only privatisation is positively associated with network expansion
Wallsten (2001)	. Also a study of telecoms performance after privatisation in 30 African and Latin American countries between 1984 and 1997, using fixed effects techniques on panel data.	. Competition significantly associated with increases in per capita access to services and decreases in the price of local-calls. . Privatisation alone is not beneficial and is negatively correlated with connection capacity. . Performance gains occur due to competition.
Bortolotti, et al (2002)	. Complements Wallsten's study. It examines the financial and operating performance of 31 national telecom companies in 25 countries, including 11 non-industrialised ones. In the sample countries, telecom firms were fully or partially privatized through public shares offering. Period covered is 1981 to 1998.	. Profitability, output, labour productivity and capital investment increase significantly after privatisation.. Employment and financial leverage decline significantly. .Competition reduces profitability, employment and, surprisingly, efficiency after privatisation.. Price regulation increases profitability. . Performance improves even where the state retained majority shareholding.
Ros and Barnejee (2000)	. Studies effect of telecom privatisation in Latin America (included only firms where at least 50% of assets or shares were transferred to the private sector).	.A positive and statistically significant relationship between privatisation and network expansion and efficiency.
Fink, Mattoo and Rathindran (2002)	. Also a study of telecoms performance. Study uses a panel data set for 86 developing countries over the period 1985 to 1999.	. Both privatisation and competition lead to significant improvements in performance. But policy reforms that included independent regulation produced the largest efficiency gains.
Zhang, Parker and Kirkpatrick (2002, 2003)	. Studies model the impact of privatising electricity generation in developing countries using panel data for up to 51 economies between 1985 and 2000 or 2001, using fixed effects panel data methodology. .	. Competition increases service penetrating capacity expansion and labour productivity, but the effect of privatisation alone is statistically insignificant except for capacity utilisation. . Establishment of an independent regulatory authority and introduction of competition before privatisation are correlated with higher electricity generation and, in the case when competition is introduced before privatisation, improved capital utilisation. . So, privatisation alone is unlikely to lead to improved performance.

Source: Compiled from Parker and Kirkpatrick (2005); Obadan and Jerome (ed.) (2004), and individual empirical studies.

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Table 4d: Summary of Empirical Findings on Privatisation

Study	Nature of Study	Empirical Findings
Gray (2001)	. Case studies of electricity privatisation in Argentina, Peru, Chile and Brazil	. Fever electricity blackouts, higher labour productivity and lower electricity losses. . Productivity increases led to lower consumer prices — by 40% within 5 years in Argentina's electricity sector and 25% within 10 years in Chile.
Plane (1991)	. A study of total factor productivity and price changes in the privatised electricity company in Côte d'Ivoire.	. Report of benefits brought to consumers by privatisation.
Gupta and Sravat (1998)	. Provides an overview of private power projects in India	. Both benefits and risks. . Private power projects introduce valuable, external, private financing to state power industries suffering from under-investment and consequent power supply disruptions. . Indian power sector has been affected by a high level of transmission loss and disputes over the initial terms of concession agreements & subsequent performance.
Gray (2001)	. A review of the evidence on private participation in infrastructure provision in a number of countries.	. In Gabon, the first two years of private water and sewerage operation led to a 25% improvement in service continuity and improved billing. . Concessions to private operators led to improved services and higher productivity in Buenos Aires, Columbia and Guinea.
Perevalov, *et al* (1999)	. An empirical study of the impact of privatisation on the performance of large and medium industrial enterprises (198 of them) in Russia, using fixed effects and random effects models over the period, 1992-96.	. Privatisation, on average, produces sound improvements only in operating profit margin (costs per unit of revenues) and to a less extent in productivity of labour. . No evidence of any influence of privatisation, on average, on total profitability of business, revenue growth, employment and level of workers wages.
Yoder, Borkholder and Friesen (1991)	. Examines the case for privatisation by testing for a correlation between privatisation and development using a data set of 45 low — to upper middle-income countries.	. Private sector is dominant in contributing an average of 74% to the GNP.. No statistically significant correlation at the 5% level between private-sector spending as a share of GNP and various development indicators. . For 46% of the countries included in the analysis, there is a negative, but insignificant, relationship between private sector spending and development.. Claims of privatisation have been overstated.

Source: Compiled from Parker and Kirkpatrick (2005); Obadan and Jerome (ed.) (2004), and individual empirical studies.

Table4e: Summary of Empirical Findings on Privatisation

Study	Nature of Study	Empirical Findings
Obadan and Jerome (ed) 2004	. Evaluates the impact of privatisation on enterprise performance in Nigeria using 27 firms that were privatised during the first phase, 1988-93, based on univariate analysis and panel data estimation.	. The univariate analysis produced mixed results. Some indicators, e.g., profitability, capital expenditure and leverage, show improvement after privatisation while others, e.g. employment, deteriorated. . The panel data analysis shows that privatisation impacted on the performance of the privatised firms, although the major driving force behind the post-privatisation performance of firms was not exactly brought out due to data limitations.
Cragg and Dyck (1999)	. Study uses data from state-owned, privatised and publicly-traded firms in the UK from 1970-94 to investigate the relationship between ownership, compensation and incentives. In other words, it attempts to answer the questions; does privatisation work by enhancing management incentives.	. Privatisation produces a statistically significant change and sizable increase in incentives. . Prior to privatisation, compensation in SOEs is unrelated to changes in financial performance. In contrast, in privatised firms, compensation is sensitive to changes in firms' financial performance while management option and shareholding serve to tie ever greater portions of management wealth to changes in shareholder value. . Ownership change provides increased compensation and incentives tied to financial performance.
Tunc (2005)	. Examines two sets of issues that explain the privatisation process in developing countries: economic incentives and opportunity structure. . Uses statistical data to examine the political and economic factors explaining privatisation in 17 countries in Asia and Latin America.	. Two factors previously neglected/ underemphasised in the privatisation literature play crucial roles in the pace and scope of privatisation: government revenue needs and political opportunity factor. . Regression results using panel data show the important factors as government revenue needs, extant degree of political opportunity and other macroeconomic factors.

Source: Compiled from Parker and Kirkpatrick (2005); Obadan and Jerome (ed.) (2004), and individual empirical studies.

contrary to the claims of Megginson and Netter (2001). The impact of privatisation has yet to be comprehensively assessed in many developing countries, particularly Sub-Saharan Africa. Empirical knowledge of the impact of privatisation in Africa is very limited unlike other developing regions and particularly the industrialised countries. Also, little evidence has yet been adduced on the broader effects of privatisation on macroeconomic performance. More importantly, there are many cases where privatisation has not led to efficiency improvement (Tandon 1995). And the failure of Russian privatisation, for example, also easily comes to mind. Russia's privatisation experience has been variously described as a failure or economic disaster. The discontent about the privatisation is reported by Nellis (1999: 9) as follows:

> What was supposed to be a program to distribute ownership and launch enterprises on a positive restructuring path became instead a transfer of productive resources from the state to a fortunate few who — unconstrained by transition, effective laws, or countervailing powers — stripped the assets from the firms, and did not restore growth and create jobs; actions that might have justified such a transfer.

Concerning the empirical analysis reported in Tables 4a-4e, some of them obviously have limitations, which place doubts on the conclusions reached. Some are underpinned by data deficiencies and/or limited scope (e.g., Galal, *et al* 1994; Obadan and Jerome 2004; Bortolotti, *et al* 2002; Wallsten 2001). Indeed, the evidence, according to Adam, *et al*, is often plagued by intractable measurement problems. Some studies do not separately identify the effects of ownership from other structural variables that might possibly impact on performance (e.g., Megginson, *et al* 1994; Galal, *et al* 1994). And in some, where this is done, there are limitations with respect to variable specification for ownership, competition and regulation (e.g., Wallsten 2001).

Concluding Remarks

What can safely be said about the empirical findings on privatisation so far is that they are far from being conclusive. As Parker and Kirkpatrick (2005) correctly conclude, the relationship between privatisation and performance improvements is complex and superior post-privatisation performance is not axiomatic. Indeed, one may be tempted to recall Bouin and Michalet's conclusion in the early 1990s to the effect that:

> the literature on comparative performance of public and private firms suggests that, although the results would seem to favour the private sector, there is no decisive evidence as regards the impact of the ownership of the

> enterprise on economic performance. In fact, none of those studies is able to compare two enterprises, one public, the other private, with an identical regulatory framework, in the same sector of activity and in the same country. The results are, therefore, considerably weakened and cannot provide a satisfactory justification for privatisation.

As Vernon-Wortzel and Wortzel (1989) further argue, private-sector ownership is no guarantee for good performance, considering that private-sector firms in every corner of the world go bankrupt every day. And some studies have drawn attention to the potential importance of differing levels of continued state ownership after privatisation. For example, Bortolotti, *et al* (2002) in their analysis of telecommunications companies in 25 countries show that performance improved even when the state remains the dominant shareholder. And in their analysis of Russian privatisation, Perevalov, *et al* (1999) find that the situation where the state has majority control is preferable to a state minority shareholding, possibly because of the absence of a monitoring shareholder in the latter case, which then permits managers to achieve their own objectives at the expense of other shareholders.

While it cannot be concluded that privatisation is a panacea which works under all circumstances and is successful in any branch of industry (Dijk and Nordholt 1994), a general consensus seems to have emerged that the enhancement of competitive forces and effective regulation are equally, if not more, important than ownership (Parker and Kirkpatrick 2005; Vickers and Yarrow 1988; Hemming and Mansoor 1988; Bortolotti, *et al* 1999 and 2002; Wallsten, 2001; Nellis and Kikeri 1989; Obadan and Jerome 2004; Gutierrez and Berg 2001; Zhang Parker and Kirkpatrick 2002 and 2003, Adam, *et al* 1992, etc.). Indeed, Parker and Kirkpatrick stress that privatisation alone is unlikely to lead to improved performance in terms of productivity and services; and that it is desirable to introduce competition and effective regulation before, rather than after, privatisation occurs. Competition generates an efficient allocation of resources, reduces managerial slack and stimulates managerial and worker efforts, leads to cost-reducing investments or quality improving expenditures (Koning 1997). Competition and regulation have mutually reinforcing attributes (Obadan 2000). Regulation ensures that enterprises do not deploy their market power to the disadvantage of consumers and generally safeguards the public interest in privatisation. Finally, there is a clear need for further studies on the impact of privatisation, particularly in Africa where, apart from the theoretical prediction, not much is known about the economic and social impacts. It will also be interesting to know the roles of regulation and competition in privatisation outcomes.

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Chapter 10

Need for Research and Summary of Research Issues

After one and a half decades of vigorous implementation of privatization programmes in Africa, with the tempo further heightened in recent years with the privatization of large-scale public enterprises in various sectors, the need has arisen for a comprehensive and systematic analysis of various privatization issues, particularly the economic and social impact. As the reviews in the foregoing sections show, so many claims have been made by advocates on behalf of privatization. But so far, empirical knowledge of the impact of privatization in Africa is very limited, unlike other developing regions and the industrial countries. Nellis (2003) also confirms this as follows: 'Rigorous assessments of privatization are increasingly available in Latin America, transition, OECD and Asian countries. Such studies are relatively rare in Africa.' The few studies that have appeared are highly descriptive/qualitative. White and Bhatia, in their descriptive study (1998), claim that their research represents the first major effort to collect data on post-privatization performance of enterprises in SSA. Makalolou (1999) and Nellis, (2003) are two other qualitative/descriptive studies along the line of White and Bhatia. But Obadan and Jerome (ed.) (2004) quantitatively assess the economic impact of Nigeria's first-phase privatization, 1988–1993. They consider their findings as preliminary. These studies were conducted when no major PEs had been privatized. Another empirical study, Azam, Nellis and Dia (2004), has a very narrow focus on performance and foreign ownership in the banking sector of the countries of the West African Economic and Monetary Union (WAEMU).

Thus, there is a clear need for a comprehensive and systematic empirical analysis of the impact of privatization in Africa. Such a study, which would have multi-country and case study components, will employ rigorous analytical techniques to address a number of the issues/questions relating to the impact of

privatization across various sectors, including the financial sector. Most of these issues/questions have been identified in the foregoing sections. They are summarised as follows:

1. What is the economic, political and social framework of privatization?
2. How is privatization defined by African countries? Broadly or narrowly?
3. What are the incentives to privatize? What are the economic and political predictors of privatization, in terms of the factors which play a role in the decision to privatize, and the pace and scope of privatization? What is the role of ideology?
4. How much of consensus is available for privatization? What role is played by ethnic, regional as well as class and sectional interests/factors?
5. What are the objectives of privatization (stated and unstated)?
6. What are the privatization methods used and what is the motivation for them? Are they adequately designed and implemented? Do they entail transparency? How transparent is the entire privatization process?
7. Who are the winners and losers that the privatization methods have thrown up? In other words, what are the political economy effects? Are the methods aimed to broadening ownership successful?
8. What is the role of donors and international financial institutions in the privatization? How does foreign financing relate to domestic financing of privatization?
9. To what extent has privatisation attracted foreign private investments? What are the types of investment?
10. Is there a correlation between privatization and economic growth/ development?
11. What are the macroeconomic effects of privatization? Specifically, what are the effects on government finances and wealth? To what use are privatization proceeds put?
12. What is the effect of privatization on the capital market?
13. Does privatization work by enhancing management incentives? How sizable are the differences in incentives between state and private ownership?

14. What are the effects of privatization on private and public enterprises? Are asset ownership and efficiency related? In other words, does ownership matter in the performance of privatized enterprises? Are private firms more efficient than state-owned enterprises? What is the role of competition and regulation?

15. What is the effect of foreign participation in privatization? Are privatized firms with foreign participation/control more efficient?

16. Privatisation may lead to greater economic efficiency. But does such privatization better serve the long-run development interests of a nation by promoting a more sustainable and equitable pattern of social progress? Related to issue number 7 above are the various social effects. What is the effect of privatization on the distribution of income and wealth? What is the effect on poverty?

17. What is the social impact of privatization on consumers? How is household welfare affected?

18. Does privatization reduce or increase employment? How is workers' welfare affected? Is the possibility of unemployment anticipated and policies put in place on retrenchment and related benefits?

19. Controversy tends to surround privatization and it attracts a lot of opposition from certain stakeholder groups. Therefore, are there any political risks in the privatization?

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