

The Public Sector, Privatization, and Development in Sub-Saharan Africa

JAMES S. GUSEH

Abstract: At the time of independence, nearly all African countries identified capitalism with neocolonialism and therefore adopted a statist approach to economic development, with government being the major instrument of development. As a result, the size of the public sector grew through the creation of public sector enterprises. On the other hand, over the years there has been a slowdown in economic growth, especially in agricultural output. With deep internal economic crisis, shortage of foreign capital and debt obligations, many African countries adopted in the 1980s certain structural adjustment measures required by international donor organizations and creditors as a condition for economic assistance, with privatization usually being a component of the structural adjustment programs. Thus, many African countries have embarked on the policy of privatization and other market-oriented reforms. Empirical investigations as to whether or not privatization promotes development of the issue have produced mixed results.

Introduction

Privatization has become an important instrument for streamlining the public sector and promoting economic development in countries around the world. Privatization refers to divestiture of public sector enterprises (PSE)---enterprises owned and operated by the state---to private owners and, more generally, the placing of a large share of the economy into the private sector. Privatization gained a major thrust in the 1980s when international donor organizations--like the World Bank--made it a major component of structural adjustment programs, established as a condition for economic assistance. Structural adjustment itself refers to "a series of economic policies designed to reduce the role of government in an economy [by] replacing government control with market incentives." ¹

Structural adjustment programs were initiated as a result of the explosive debt crisis of the early 1980s. The rise to power of groups espousing neo-liberal economic ideas during the political tenure of the Reagan and Thatcher governments in the United States and Great Britain, respectively, accelerated the placement of structural adjustment on the economic development agenda during that period. While stabilization programs of earlier post-war decades achieved successful monetary, fiscal, and trade policies without economic restructuring, structural adjustment programs in the developing world during the 1980s and early 1990s were associated with the adoption of free-market policies as a condition for international assistance.

The 1980s can be regarded internationally as the decade of privatization. "From the middle of the 1970s, worldwide sales of state enterprises reached a record total of over \$185 billion by the end of the 1980s." ² Although the public enterprise sector expanded in most countries during much of the post-World War II period, this sector contracted or remained the same in most countries during the 1980s, principally due to privatization policies.³ Since 1980, worldwide

<http://www.africa.ufl.edu/asq/v5/v5i1a3.pdf>

sales of PSEs have risen faster. In 1990 governments worldwide sold off \$25 billion in PSEs.⁴ Total sales increased to \$69 billion in 1992 (⁵) and exceeded \$175 billion over the period 1990 to 1993.⁶ Assets of privatized entities are projected to exceed \$600 billion by the year 2000.⁷

While the policy of privatization may have originated in the industrialized countries, it has been rapidly adopted in the developing world. Over the years in many developing countries, there has been a slowdown in economic growth, especially in agricultural output. Increasingly, therefore, they are reducing the size of the public sector and turning to market-oriented reforms. Moreover, as a result of the declining economic growth in these countries, international donor organizations and creditors, such as the World Bank and the United States government, have required certain structural reforms as a condition for economic assistance, with privatization usually being a major component of this structural adjustment package. Privatization has been seen by some governments and international donor organizations as a policy that will help less developed countries improve the performance of their economies by reducing the size of the public sector and enhancing the performance of the private sector. Thus, many African countries have embarked upon privatization.

The purpose of this study is to analyze the factors that led to the adoption of the policy of privatization in Africa, with emphasis on Sub-Saharan African, and to review the policy as an instrument of development. The paper begins with analysis of the contribution of the size of public sector to economic growth in Africa. Such an assessment is important, because the growing trend in the size of government has been criticized for the decline in economic growth.⁸

Second, with the policy of privatization perceived as a major solution to the slowdown in economic growth, the issue becomes whether or not privatization promotes development at a faster rate than would otherwise happen. This study addresses this issue through a review of empirical studies on the relationship between privatization and development. The results should provide further insights into the effects of the privatization policy adopted in Sub-Saharan Africa. The study concludes with some policy implications.

THE PUBLIC SECTOR AND PRIVATIZATION

In the struggle for independence from colonial rule, ambivalence toward capitalism was the hallmark of most nationalist movements in Africa.⁹ At the time of independence, most African countries identified capitalism with colonialism rather than with entrepreneurship and free enterprise. As Bruce Bartlett stated, "capitalism in any form was identified with imperialism and therefore rejected as neo-colonialist."¹⁰ As a result, virtually every African country adopted some form of socialism or statist approach to economic development. Many external advisers and the economics profession recommended a major role for the state in economic development. Thus, governments became the principal actor in economic activities and the major instrument of development in many African countries. This has led to an increase in the size of the public sector through the creation of numerous government agencies and state-owned or public-sector enterprises.

Goran Hyden described the original rationale for establishing these enterprises as follows: "In the absence of an entrenched class of local capitalists, many governments felt a need to resort to public enterprises as the only alternative to counteract the influence of foreign capital

and to accelerate the development of local resources. The public enterprises would take the role played by private entrepreneurs in other countries and thus help to harness, mobilize and exploit resources which would otherwise lie idle or be developed only by foreigners. The profit generated by these bodies, moreover, would accrue to the state and thus be available for public investment and for fostering social welfare goals of the new governments. In those countries which adopted a socialist strategy of development, governments would add to this list of reasons for a rapid expansion of the public sector the objective of social equality. A dominant public sector would make equalization policies easier."¹¹

Other points of view have been advanced for a larger role of government in the process of development. One point is that government should be assigned a critical role in the process of economic development. Another is that a large government can become a powerful engine in economic development. Arguments in support of the latter include, inter alia: "(i) role of the government in harmonizing conflicts between private and social interests; (ii) prevention of exploitation of the country by foreigners; and (iii) securing an increase in productive investment and providing a socially optimal direction for growth and development."¹²

Thus, since independence, the role of the state in economic activities has increased sharply in Africa through the creation of numerous public-sector enterprises. For example, in the late 1980s, "state enterprises bulk[ed] larger in proportion to total economy activity than it [did] in any other market-economy region in the Third World."¹³ It is estimated that about three thousand enterprises are fully or partially controlled by governments in Africa. The size of government in the economy had grown sharply between independence in the 1960s and the era of structural adjustment in the 1980s.

Although there are various measures of the size of government in the economy, the measure employed in this study is the ratio of government consumption expenditure to gross domestic product (GDP). For many countries, government consumption expenditure consists of the following categories: "1) outlays for wages and salaries of civil servants and the military; 2) outlays on nondurable goods and services, including those for public sector employees, maintenance, and all spending on military equipment; 3) interest payments on government debt; 4) transfers to subnational government; and 5) subsidies and other transfers to individuals."¹⁴ This measure, regarded as the standard specification of government size, assesses the effect of public sector expansion on the underlying growth rate.¹⁵ It provides a useful indication of the overall influence of the public sector in the economy as a whole.¹⁶

Measured as the ratio of government consumption expenditure to GDP, government size in Sub-Saharan Africa increased from about 20 percent in the early 1960s and 1970s to about 28 percent and 29 percent in the early 1980s and 1990s, respectively.¹⁷ Much of the growth during the initial period was the result of the newly independent states assuming the role of nation building from colonial states. The states tended to mobilize their physical and human resources for socioeconomic development. Countries that were endowed with natural resources, such as Liberia with iron ore, Ghana with bauxite, and Nigeria with oil, tended to use the revenue from the sales of the resources to expand their public sectors. Thus, the state became the major actor in economic activity and development.

The extent of state involvement in the economies of sub-Saharan Africa is summarized in a 1986 report by the World Bank as follows:

"Public sector employment is half of all modern sector employment, compared with only one-third in Asia. Allowing the country size, public enterprises are more numerous than in most other developing countries, and they engage in a wider array of activities. Public investment accounts for the bulk of investment in the formal sector."¹⁸

The early 1970s experienced a decline in economic performance as a result of the first OPEC oil crisis in 1973. The slowdown in economic growth led to a decline in income to various sectors of the economy including the public sector. As a result, the share of government spending as a percentage of GDP declined slightly during this period. To continue the trend of government expansion, oil importing countries embarked on heavy borrowing. Ironically, some of the funds for borrowing were recycled funds from oil exporting countries.

Table 1 provides external debt statistics for Sub-Saharan Africa. The external debt as a percentage of GNP more than doubled over the period 1980 to 1995. It increased from 30.6 percent to 81.3 percent. Similarly, debt as a percentage of exports increased from 91.7 percent in 1980 to 241.3 percent in 1995. With substantial borrowing to finance government activities, including public sector enterprises, the size of government increased dramatically in the 1980s and 1990s.^{Table 1}

While the size of the public sector has been growing, the rate of economic growth has been slow. A broad overview of the economy of Sub-Saharan Africa shows that the average annual rate of economic growth was over 10 percent in the 1960s and declined below 2 percent in the 1970s and 1980s. During the 1980s, most of the national economies were in a state of near or partial collapse. Over the period 1990 to 1998, annual rate of economic growth averaged slightly over 2 percent to 2.2 percent. In 1997-98 the average annual growth rate of per capita was negative (-0.4 percent). The growth rates in the 1980s and 1990s have been below the average annual rates of population growth of 5 percent and 3 percent, respectively.

As a result of the declining rate of economic growth, African countries are increasingly reducing the size of the public sector and are turning to market-oriented reforms. As discussed in the previous section, the declining economic growth in these countries has led international donor organizations and creditors, such as the World Bank, the European Union, and the United States government, to require certain structural reforms as a condition for economic assistance, with privatization normally being a major component of this structural adjustment package.

PRIVATIZATION AND ECONOMIC REFORM IN AFRICA

Table 2 presents a summary of privatization activity in Sub-Saharan Africa in various years and by economic sectors. By 1998, 3,165 privatization transactions were completed, leading to total sales value of US\$6,426 million. Of these transactions, about 50 percent were completed prior to 1994, and the other 50 percent were completed over the period 1994 -1998. It is therefore clear that by 1999 the pace of privatized firms in value terms was falling. This is due largely to the political unpopularity of privatization. Of the total transactions, manufacturing constituted about 75 percent, followed by agricultural production and process with 50 percent and services with 40 percent. The rest of the transactions consisted of trade with 10 percent, financial with 5

percent, and other with 6 percent. Most of the privatized industries had been built by state authorities to encourage manufacturing under import substitution policies.^{Table 2}

Turning to strategies of privatization, a wide range of methods have been employed in Africa. Table 3 presents the methods used up to the end of 1996. The sales of shares through competitive tender appears to be the principal method of privatization, constituting about a third of the total privatization. Open competitive bidding has been one of the conditions favored by donors. However, formal liquidations and asset sales combined represent the same proportion of transactions, a reflection of the poor condition of many state-owned enterprises.¹⁹ The number of non-competitive methods exceeded the number of sales to shareholders with pre-emptive rights, a reflection of a degree of non-transparency and skepticism about privatization in Sub-Saharan Africa.²⁰ It is also a reflection of the existing laws that grant current shareholders pre-emptive rights in buying out the state. It is reported however, that concerns about transparency are receding because of the availability of more information to the public by the implementing agencies and the increasing involvement of the private sector in the privatization process.^{21 (Table 3)}

The pace of privatization across the continent is not uniform. The pace is picking up in some countries, while in other countries the process is just beginning. In others it has slowed down. In terms of the number of transactions completed in each country to the end of 1998, most privatization activities have taken place in Mozambique (579), Angola (331), Zambia (253), Ghana (217), Tanzania (198), Kenya (189), Ethiopia (125), and Guinea (117).²² It is interesting to note that the two countries that have recorded the most privatization transactions, Mozambique and Angola, are neither Anglophone nor Francophone countries, but Lusophone countries. Both are formerly Marxist command economies. This, perhaps, reflects the need and determination of these countries to move away from socialism and rebuild their war-torn economies.²³

Despite the adoption of privatization policy, the Sub-African region still ranks low in the pace of privatization. According to the US National Center for Policy Analysis, among the regions in the world for the period 1988-1995:

"Latin America and the Caribbean was the leading privatization region with total sales of about \$54 billion or 46 percent of the total amount of proceeds from privatization.

East Asia was next with sales of \$28 billion or 25 percent, followed by Europe and Central Asia (which includes the formerly planned economies of Central and Eastern Europe and the former Soviet Union) with almost \$20 billion or 17 percent.

The rest of the developing world combined [including Sub-Saharan Africa] was responsible for only about 12 percent of the value of sales."²⁴

These data and the fact that state-ownership represents about 10 percent of GDP in developing countries on average suggest that a lot of assets are still controlled by states in Sub-Saharan Africa and other developing regions.²⁵ The major factor that has restricted the pace of privatization in Sub-Saharan Africa is the underdevelopment of the capital markets. This limitation has affected the pace of privatization in terms of how many enterprises could be put up for sale and the methods employed for broadening ownership. As a method of privatization, capitalization schemes have not been tried in Africa ²⁶, while they have been employed in some Latin American countries. However, according to Jean-Louis Sarbib, Vice President of the

African Region of the World Bank, a lot of effort is going into capital market developments along with financial sector reforms in Africa.²⁷

Despite these problems, the lessons learned indicate an increasing number of privatized firms deserve closer attention. The question is whether or not privatization helps promote development. This issue is addressed in the next section where the relationship between privatization and development is reviewed.

PRIVATIZATION AND ECONOMIC GROWTH: POLICY CHOICES

Would the limited amount of privatization help the goal of accelerated growth in Africa? One of the issues involved in assessing the impact of privatization is measurement of performance. While a private enterprise tends to be assessed in terms of financial performance, a public sector enterprise (PSE) may have multiple functions, such as commercial and developmental functions. For example, in Liberia, the state-owned radio station performed both development functions, such as operating a rural communication network, and also commercial functions. Thus, a PSE can be assessed in terms of financial performance, as well as its effectiveness, efficiency, economy and contribution to democracy.²⁸ To assess PSEs with multiple functions only in terms of profitability may not present an accurate assessment of the performance of such enterprises.

Another factor in measuring performance in the public sector deals with the ownership of performance measurements. Several public agencies may contribute to the realization of a certain goal or output, and how credit for these contributions should be allocated may be an issue. Graeme Hodge provides an example of this situation as follows:

"[P]olice, transport accident commission, road and traffic authorities, emergency services associated with on-site trauma, medical support and transport, hospitals, community groups, and educators are some of the contributors to the general aim of reducing road accident trauma. None of these contributing agencies, however, would be wholly responsible for the overall level of road trauma occurring over any one particular time period. In any single year, all agencies would have partial ownership of the road trauma outcome in the community."²⁹

Ownership of performance measurement can also affect the performance of services. An agency may want to receive credit for providing a service that involves the cooperation and contribution of many organizations. By insisting on receiving credit, the agency may prevent the services from being provided. For example, in the United States "several law enforcement agencies knew about a major drug shipment, but they allowed it to slip through their fingers . . . because they would not agree about which of the 'cooperating' agencies would make the actual arrest and receive the media attention."³⁰

Although there are different forms of privatization with different objectives, most evaluations do not distinguish the effect of each form of privatization on development. Forms of privatization include contracting out, enterprise sales, public-private partnerships through joint ventures, and delegation. Different methods of privatization result in different outcomes, and the privatization agency must use the most appropriate method of privatization for different companies, industries, and sectors.³¹ For example, if the goal is to restructure PSEs with little or no transfer of ownership and management control, then the most appropriate method is

commercialization of PSEs by requiring cost recovery and eliminating their subsidies and monopoly status.³² If the objective is to reduce or eliminate the public sector's role in providing goods or services and to encourage private sector provision, the appropriate methods include delegation of responsibility of nongovernmental organizations and the private sector and provision of state guarantees or incentives for the private sector or nongovernmental organizations to provide services.³³ Whether these different forms of privatization have different effects on growth and development remains to be tested.

Whether privatization has a positive or negative impact on development seems to depend on factors such as the variables and model specifications employed. For example, studies that have regressed the rate of economic growth on government expenditure or tax revenue as a share of GDP have found a significant negative relationship, *ceteris paribus*.³⁴ This may indicate that growth in government activities tends to harm economic expansion overall. On the other hand, studies that have regressed the rate of economic growth on the growth rate of government expenditure have found a significant positive relationship, *ceteris paribus*.³⁵ Thus, the model specifications employed tend to determine the nature of the effects of the public sector on economic growth. The government expenditure variable employed in these studies is government consumption expenditure, defined in the previous section.³⁶

Accordingly, a debate in the literature centers on determining the appropriate specification of government size in assessing its impact on economic growth. According to Landau, although the correct approach would be to include government in a general model of economic growth, he argued that such a model does not exist and that "Economic research is still in an underdeveloped state [with] little known about the impact of public production."³⁷ Thus, Landau (and others) specified government size as the share of government consumption expenditure (G) in GDP (i.e., G/GDP).³⁸ This specification has been found to be negatively correlated with economic growth.

Ram, however, challenged this specification. He argued that the use of the variable G/GDP in the production function lacks a theoretical foundation and thus would be ad hoc. Adapting a two-sector production function framework, he showed that the appropriate variable for investigating the effects of government size on economic growth is the growth rate of government spending (i.e., dG/G).³⁹ His results showed a positive correlation between government size and economic growth.

Despite the two views on the specification of government size, Conte and Dard have shown that both specifications are appropriate, with Ram's specification measuring the short-run impact of government and the other specification measuring the long-run impact.⁴⁰ Thus, the short-run impact of the growth in government size on the economy is positive, while the impact of government on the underlying rate of economic growth is negative. These differences on the impact of privatization on growth, make it hard to arrive at a hard and fast answer on the likely impact of privatization on economic growth in Africa.

Conclusions

Since independence, the size of government in African countries has grown through the creation of public sector enterprises. On the other hand, the rate of economic growth has been declining. Whatever the results of studies on the relationship between privatization and development, many African countries are placing large shares of their economies in the private sector in order to reduce the size of government and improve the performance of their economies.

Growth in the size of government, measured as the share of government consumption expenditure in GDP, has been found to be directly associated with a decline in economic growth. Growth in the share of GDP consumed by governments tends to be a drag on growth. That is, government consumption is a "net tax on society with few corresponding benefits."⁴¹ Besides the direct negative impact of government on the economy, growth in government also adversely affects economic growth through an indirect approach. That is, more government lowers savings and investment which in turn retards economic growth.

Other studies also suggest that a larger government size may interfere with efficiency and economic growth. Some of the reasons that have been advanced include: "(i) government operations are often conducted inefficiently, (ii) the regulatory process imposes excessive burdens and costs on the economic system, and (iii) many of government's fiscal and monetary policies tend to distort economic incentives and lower the productivity of the system."⁴² Additionally, corruption tends to be prevalent in the public sphere. According to the World Bank, "many privatization efforts have been racked by corruption, undermining confidence in both the government and the market economy."⁴³

As Brian J.L. Berry, Edgar C. Canaling, and D. Michael Ray have noted: "Centrally directed [economic] systems do not work and cannot compete. They produce only sporadic growth, assure only a low-level equality that is violated by party-membership privilege, and quite demonstrably have been far more destructive of the environment than political and economic systems of any other kind."⁴⁴

Brian J.L. Berry, et al. recommend that economic statism of central direction would have to be replaced by individual initiatives and the discipline markets in the economic arena, and individual freedoms and democratic institutions in the sphere of politics; private enterprise and competition would have to replace state monopoly and public-sector enterprises.⁴⁵ Competition is essential, because it encourages efficiency and provides incentives for innovation. As Bruce Bartlett said, "whatever faults it may have, there is no longer any doubt that free-market capitalism has the greatest capacity to produce goods and services of any economic system ever devised."⁴⁶ According to Graeme Hodge, who has conducted an international review of privatization, "this changed intellectual climate has also been further bolstered by the failure of centrally planned economies and the relative success of Western capitalist democracies."⁴⁷ Little wonder, then, that market systems are triumphing across the globe!

With growth in the size of the public sector being associated with a slowdown in economic growth, the traditional emphasis of African countries on government as the instrument of development needs to be reexamined. For example, the World Bank compared economic performance of developing countries in Sub-Saharan Africa and East Asia.⁴⁸ The Bank found

that in 1960 per capita incomes in the Asian countries were only slightly higher than those in Africa, while consumption expenditures of African governments were higher than those of the Asian governments. However, by the 1990s, incomes in East Asia were more than five times those in Africa, while the government size in Africa had grown to one-and-a-half times that in East Asia.

Reducing the size of the public sector is seen therefore as essential to lower inflation and to allow for new domestic and foreign investments. As stated by the National Center for Policy Analysis, "Privatizations have a particularly strong influence over decisions to invest, and each dollar of privatization revenue generates an extra 38 cents in new investment with financial and infrastructure privatizations having the most positive effect on other foreign direct investment."⁴⁹ Thus, a policy based on a minimal role of government in economic activity may be the best route towards economic growth and prosperity in Africa. The need for such an institutional reform is of high urgency.

It is therefore urgently necessary to critically review and reconsider the traditional emphasis on government as the major source of employment and on State monopoly and control over productive assets and a wide range of economic activity. To translate this awareness into policy constitutes one of the major political-economic challenges facing Sub-Saharan African countries in the twenty-first century.

Tables

Table 1. External Debt for Sub-Saharan Africa

	1980	1995
Total External Debt (million \$)	84,119	226,483
External Debt as Percentage of GNP	30.6	81.3
External Debt as Percentage of Exports	91.7	241.7
Debt Service as Percentage of Export	9.8	14.5
Multilateral Debt as Percentage of Total External Debt	9.0	24.3

Source: World Bank, World Development Report 1997: The State in a Changing World. Washington, D.C., 1997, p. 247.

Table 2. Privatization Activity in Sub-Saharan Africa by Period and Economic Sector 1994-98

A. Transactions Completed by Period

Year	Number of Transactions Completed	Percent
Before 1994	1,582	50.5
1994	352	11.2
1995	485	15.5
1996	422	13.5
1997	240	7.6
1998	53	1.7
Total	3,134	100

B. Transactions Completed by Sector

Sector	Number of Transactions	Percent
Agriculture Production & Processing	655	24.1
Financial	120	4.4
Manufacturing	826	30.4
Services	636	23.4
Trade	299	11.0
Other	182	6.7
Total	2,718	100

Source: The World Bank Group, The World Bank Group-Country Data: African Development Indicators. <http://www.worldbank.org/data/countrydata/adi/adi.html>

Table 3. Methods of Privatization and Number of Transactions to End 1996

Methods of Privatization	Number of Transactions
Share Sales by Competitive Tender	854
Liquidations	458
Asset Sales by Competitive Tender	421
Non-Competitive Sales of Shares	291
Leases/Concessions	187
Pre-emptive Rights Share Sales	75
Public Flotations	69
Management/Employee Buyouts	48
Joint Ventures	47
Management Contracts	39
Restitutions to Former Owners	36
Transfers to Trustees	27
Non-Competitive Sales of Assets	25
Debt/Equity Swaps	7
Unspecified Methods	100
Total	2,718

Source: Jean-Louis Sarbib. "Privatization in Africa: Present and Future Trends." The World Bank Group. Regions: Sub-Saharan Africa, Abidjan, May 21, 1997.
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