PRIVATISATION: A STUDY OF GHANA

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DECLARATION

I hereby declare that the work herein, now submitted as a thesis for the degree of Master Of Business of the Northern Territory University is the result of my own investigations, and all references to ideas and work of other researchers have been specifically acknowledged. I hereby certify that the work embodied in this thesis has not been accepted in substance for any degree, and is not being currently submitted in candidature for any other degree.

Signature:  
Date: 10-07-02
ACKNOWLEDGEMENT

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ABSTRACT

Privatisation has become a major policy instrument in many countries since the mid-1970s. In many developing countries like Ghana, Privatisation was embraced as part of wider Economic Recovery programmes/Structural Adjustment programmes on the recommendations of the International donor agencies, notably, the World Bank and the IMF. The primary reason usually cited in defence of Privatisation is to improve the efficiency of the public sector and thus reduce the excessive drain of the sector on national budget.

The global trend in Privatisation and the importance attached to it by many countries, particularly Ghana calls for better knowledge and understanding of the concept not only by policy makers but also by the citizenry at large. Such knowledge will not only remove various prejudices in the minds of policy makers but also remove current resistance being put up by the citizenry. This study is therefore aimed at acquiring an in-depth knowledge of the economic concept of Privatisation. The study largely covers available literature on Privatisation, with an extensive examination of both theoretical and empirical studies available on the subject.

The purpose of this thesis is to thoroughly examine the Divestiture Programme of Ghana to ascertain the nature and overall direction of the programme. Problems encountered in the process are also analysed as well as the achievements made so far. A more analytical review of the process was however hindered by lack of data especially on the pre-divestiture records of SOEs. However, the scanty information
available indicates that the divestiture programme so far has succeeded in turning the fortunes of some hitherto inefficient SOEs around, and has had some observable impact on employment as well as on the growth and development of the Ghana Stock Exchange. These observations are however not conclusive and there is the need for further analysis to determine the extent to which the programme has met its objectives. Nevertheless, the basic aim of an in-depth understanding of the concept of Privatisation has been largely achieved in this study.
Ghana obtained her independence from Britain on the 6th March 1957, becoming the first Black African country south of the Sahara to have done so. The first government under Dr. Kwame Nkrumah pursued very rigorous socialist policies, with a lot of support from the then socialist/communist countries of Eastern Europe. Under his regime many state owned enterprises and public corporations were established and all major economic activities were concentrated in the hands of central government, notwithstanding the gross inefficiency and low productivity that characterized the operations of most of these firms.

The situation was further aggravated by the subsequent military regimes who after take over launched rather vindictive attacks on the few private sector practitioners (including foreign investors), seizing and nationalizing private enterprises, industries and other assets under the guise of "house cleaning exercises". Fiscal and monetary policies adopted by these governments included stringent trade and currency controls, leaving an economy that was on the verge of virtual collapse by the end of 1982.

The state of the economy of Ghana as at the end of 1982 can be summarized as follows:
1. A large inefficient and unproductive public sector with government controlling almost every economic activity.

2. Low per capita income (about US$200 end of 1982)

3. A precipitous decline in GDP

4. High inflation (123% at the end of 1982)

5. Virtual collapse of the private sector.

In 1983, Ghana, under the Provisional National Defense Council (PNDC) government of Flt. Lt. J.J. Rawlings launched an Economic Reform Program (ERP) and has since undertaken a series of comprehensive macroeconomic and structural adjustment reforms, aimed at reversing the economic decline that had characterized the state of the economy for almost two decades. The reform program included the following:

1. Restructuring of institutions
2. Diversifying the economy
3. Balancing the national budget
4. Liberalizing trade and currency
5. Attracting direct private investment
6. Improving the economy’s capacity to adjust to both external and internal shocks and to generate sustainable growth and development.

As a consequence, government has over the past few years initiated specific policies to lay a firmer foundation for private sector development. Policies so far initiated include the following:

1. The program of divestiture (privatization) of state owned enterprises.
2. Introduction of monetary and banking sector reforms
3. Introduction of a well organized capital market that will serve as a vehicle for the mobilization of capital funds for growth and development, (culminating in the opening of the Ghana Stock Exchange in 1990)

4. Reduction of corporate taxes for most business activities from 45% to 35%.

5. Rehabilitation of roads, ports, and telecommunication systems.

Of all the policies so far enunciated however, Privatisation remains not only the most controversial, but also the most abhorred among the Ghanaian populace.

**Privatisation as a global phenomenon.**

Although it may appear very new to the average Ghanaian, Privatisation is not altogether a new concept to the world. It has become a major landmark in the economic policies of nearly all countries in the world. Following the major strides made by the UK from the late 70s, followed by the USA in the early 80s, many other countries have followed the trail particularly the planned economies in Eastern Europe. Like all other developing countries, Ghana is highly influenced by trends in major economic policies around the world and has not been left out in this current wave of privatization either. The worldwide proliferation and dominance of Privatisation as an economic tool could not escape the attention of economists and researchers who to date have completed a large number of studies on this concept. For example, Vickers & Yarrow 1987; Vickers & Yarrow 1988, 121-430;

Following the collapse of communism/socialism and for that matter the planned economies of Eastern Europe, many of their followers, particularly in Africa, have had to make significant changes to their economic policy directions. Again a large number of studies have been completed on privatization in both the developing countries and the transitional countries of Eastern Europe. Notable among these studies are, Berg 1993; Dijk 1994; Zank 1991; Ott 1991; Bala 1997; Boubakry & Cosset 1998; Kikeri et al 1992; Frydman et al 1997; Megginson et al 1994; Due 2000; Dzakpasu 2001; Etukudo 2000; Bennel 1996; White & Bhatia 1998; Martin 2001; Lopez-Calva 1998; La Porta & Lopez-de-Silanes 1997; Nankani 1988; Nellis 1994; Perotti & Laeven; Roth 1987; Walle 1989; Ramanadan 1988; Cook & Kirkpatrick 1988; Adda 1989; Bavon 1998; Boachie-Danquah 1998; Fredrich-Ebert Foundation 1994; Opoku 1999 and Alexander 1989

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1 In the first budget statement presented by the new NPP government for year 2001, corporate tax was further reduced to 30% for listed companies and 32.50% for unlisted companies. (Source: Government of Ghana Budget Statement for Year 2001)
Pressure from International Donor Organizations

Like many other developing countries, the economy of Ghana continues to be heavily dependent on external loans and various forms of financial assistance from donor agencies. Total debt /GDP ratio was 129.4 percent as at end of 2000 whereas Gross Domestic Investment/GDP as at the same period was 23.7 percent, with total external debt standing at US$6.7billion (World Bank 2001). It cannot be denied that the Breton Woods institutions (The IMF & The World Bank) largely influence economic policy decisions in Ghana; mainly under the guise of conditions attached to loan agreements.

Privatisation in Ghana (and perhaps many other developing countries) is thus seen as a means of dealing with foreign debts (as against the budgetary deficits that western governments face) and to attract new foreign capital. See Dijk and Nordholt, 1994. The pressure on the government to go on a full-scale privatisation especially in the utility sectors (Water and electricity) calls for further evaluation of the programme. As noted by Kirkpatrick, (1989) governments of developing countries are unwilling to accept the current policy priorities of these international agencies, especially those that are accompanied by a cohort of international merchant banks and managerial consultancy firms, who simply drain away half of the funds available in the form of fees and salaries, whilst the poor citizenry are left to bare the brunt of these harsh policies.

General inefficiency associated with SOEs

It has become an acceptable notion that SOEs all over the world are generally inefficient in their operations. In Ghana, political interference made
some SOEs increase their employment levels to a point where productivity was extremely low, with financial losses characterizing their operations, as noted by Begashaw, 2000. However, since SOEs are established to perform different functions, using financial performance alone as a general yardstick for measuring efficiency will not be justifiable. Also, some SOEs are engaged in the provision of basic social amenities like water and power and these until the start of the privatization programme were heavily subsidized by government. There is no squabble about ‘making more profitable’ an SOE established to undertake purely commercial activities. But much cause is given for concern with regard to those others for which profit making was not the original motive for their establishment. Economic literature abounds with various arguments against the wholesale entry of the private sector into the provision of public sector goods and services. A research study into the concept of Privatisation should help to unearth some of the teething problems associated with the process and also bring out possible solutions.

**Burden to the Budget**

One of the most common reasons for privatisation worldwide is the reduction of the financial burden of the public enterprise sector on government finances. This assertion is closely linked to the problem of inefficiency noted above. In Ghana, during 1985-89, net outflow from government to 14 core public enterprises (which accounted for 60 percent of employment, 72 percent of sales and 67 percent of value added by the public enterprise sector) averaged about 11 percent of total government expenditures, reaching 17 percent in 1989. See IDA, 1991 and IMF (1996). The situation
clearly becomes alarming when one considers the fact that there were 350
state-owned enterprises as at the start of the Divestiture Programme in 1988,
most of which were making heavy losses, and about 20 percent of recurrent
spending went in loans and subsidies to keep them afloat. The transfer of
such loss making firms to private hands that are more capable of performing
such economic activities is in the right direction. However, evidence on the
ground shows that not all the firms so privatized tend to meet expectations.
The underlying factors for their continuous loss making ought to be further
examined, making a study of this nature very important.

The Size and Contribution of the Public Enterprise Sector

As noted earlier, Ghana chose a state-centred approach to economic
development after independence, and by the early 1980s, the public sector
had completely dominated production, accounting for 75 percent of formal
employment. State enterprises were involved in almost all sectors of the
economy, including mining, agriculture, finance and banking, manufacturing,
trade, construction, energy, and telecommunication. Whereas the
advantages of privatization may be numerous, the social costs that go with it
ought to be equally assessed. Unemployment (for whatever length of time)
is a great social issue particularly in a country where the extended family
system subscribes to a long chain of dependents. There is a further pressure
on the meagre incomes of the average household who will have to pay
higher prices for goods and services hitherto heavily subsidized by
government. Efforts by government through the Programme of Actions to
Mitigate the Social Cost of Adjustment (PAMSCAD), to compensate for
adjustment related job losses etc had woefully failed. There is therefore the need for a study of this nature to assess the extent to which the programme has come so far in meeting the aspirations of the people of Ghana.

Privatisation and the people

It cannot be denied that the privatisation programme in Ghana so far has achieved some degree of success. However, public reaction and other less obvious factors on the ground tend to give much cause for concern. The most important issues that have beleaguered the privatisation process over the years include the following:

Campaign tool for opposition politicians:

The tendency of politicians in the opposition to see nothing good in incumbent government's policies continue to manifest in opposition parties painting rather gloomy pictures of the privatisation process in the minds of the public. This problem may not be peculiar to Ghana. As observed by Etukudo (2000), in Africa generally, political factors often assume overbearing influence on the implementation of economic reform programmes. Such factors express themselves as vested interests, be they ethnic, class, geographical, professional associations etc. Unfortunately for Ghana, and perhaps for most African countries, policy programmes prescribed under conditions of deteriorating economies, do not arm those who implement the programs with the requisite political skills and finesse to contain obvious opposition and hence the spate of stalling and postponements of implementations in the face of protest.
Lack of transparency:

Lack of transparency in the disposal of some key state owned enterprises (particularly through strategic investor financing and sale of assets) has also aroused a lot of criticism in the past. As observed by Berg (1987), intellectuals in virtually the entire developing world are against divestiture. They see it as selling off national assets to the power brokers, which to them is a very terrible idea. Shrouding divestiture transactions in secrecy only goes to aggravate the in-built fear of corruption. According to Dzakpasu (2000), the Divestiture Implementation Committee (DIC) of Ghana, has since the late 1993 come under intense criticism from a suspecting and skeptical general public that accused the Committee of a) lack of transparency in its operations, b) non-involvement of the private sector operators in its membership c) some perceived inefficiencies in the operations of the secretariat d) the virtual dominance of the Social Security and National Insurance Trust (a government organization) resulting in the crowding out of the local private sector, e) increasing the rate of unemployment through its divestiture activities. It is the view of many a critic that some SOEs were sold out to party affiliates at ridiculously low prices. They contend that proceeds from privatisation could have far exceeded the US$873 million\(^2\) so far accrued to the state.

Social cost of privatisation:

Redundancy, staff lay-offs and other labour related problems associated with the privatisation process make the process very unpopular among labour groups, spear headed by the Trades Union Congress. The social cost of privatisation arising out of unemployment problems still remains to be properly assessed and effectively dealt with. Battles over workers severance pays continue to rage several years after divestiture. A typical example is the case of Sabbat Motors; formerly ATS where it has become increasingly difficult for the new owners to operate the firm because of frequent closures caused by workers agitations. There is also the tendency for employees to run down companies upon information that these companies have been listed for privatisation. Some researchers do not however consider privatisation as posing any serious threat to employment. Etukudo (2000) showed that the effect of privatisation on employment in state enterprises in Zambia has not been very severe, adding that the job market has rather now become quite flexible. Sheshinki and Lopez-Calva (1999) also found the effect of privatisation on unemployment to be ambiguous, concluding that privatisation has a negative effect on employment in the short run, but positive effects in the medium and long run. It is very doubtful if the same conclusions can be drawn about the situation in Ghana.

Utility services and the rising cost of living:

The larger section of the Ghanaian populace has generally repulsed the privatisation of the utility industries notably water and electricity supply. The
previous NDC government had been very cautious in treading on these sensitive grounds and was unable to make any clear headway until it was voted out of power in December 2000. The ruling NPP has already announced plans to introduce private sector participation in the supply of water and electricity, a decision that has already fuelled wild agitations with some labour groups already threatening strike actions. The effect of privatisation on the rural population in such areas as transport, electricity, water, banking and health begs for much deeper reflections. Public utility extends to the rural population as a social service with no profit motive. To date most rural communities in Ghana continue to enjoy electricity and water supply at heavily subsidised rates. The fact that the two major commercial banks privatised had to close most of their rural branches after privatisation gives much credibility to the fears being raised against utility service privatisation.

According to Hanke et al (1987) one of the major obstacles to more rapid privatisation in Less Developed Countries was simply a lack of knowledge about how to go about the process. It is imperative that a critical assessment is made of the privatisation process in Ghana to determine the extent to which the primary objectives of the policy have been met, against the backdrop of the issues outlined above.

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3 A formal remark made by Emmanuel Agbodo, former Executive Secretary of the DIC, Ghana at the Third Pan-African Investment Summit (September 1999). Source: PSIRU database.
Objectives of the Study

This study is aimed at investigating the economic concept of privatisation with a view to develop an in-depth understanding of the concept as a whole, but with a special focus on the privatization process in Ghana as follows:

1. The objectives of privatisation. This will involve a close study of the growth of SOEs in Ghana, their associated problems and how privatization is intended to solve such problems.

2. The different techniques of privatisation

3. Impact of privatisation on various sectors of the economy. Whilst addressing this issue, special attention will be paid to the economic efficiency of the firms so privatised, impact on employment and also implications for stock market development.

On the whole, the study shall seek to determine whether privatisation is truly desirable in Ghana, and whether the performance of newly privatised firms has lived up to the expectations of the government and people of Ghana, and perhaps the development agencies notably the World Bank and the IMF. It is anticipated that the result from this study will go to an appreciable extent to clear the minds of most Ghanaians of the myths and prejudices that still cloud their understanding of the concept of privatisation. Above all, conclusions drawn from the findings of this study shall be placed at the disposal of policy makers for possible consideration in future privatisation efforts in Ghana.
That the issues and objectives discussed above are of prime importance cannot be overemphasized. Primarily, the importance of these objectives can be traced back to the very objectives or rationale behind the privatization process in Ghana, namely, a) to reduce or eliminate the financial burden of the public sector on government finances, b) to improve the overall efficiency of the Ghanaian economy, c) to downsize the public sector, d) to refocus the role of the state in the economy, e) re-capitalization of state-owned enterprises with technologically obsolete plant and equipment, f) generating employment for Ghanaians, g) promoting the development of the private sector as the engine of growth, and h) removing the fiscal and managerial burden imposed on government by state-owned enterprises. The question on the lips of many worried observers is whether these objectives are being achieved at all. Whereas the politicians and the policy makers will be quick to answer in the affirmative, the people who bare the brunt of the policy can only do so with much hesitation. The search for an answer to this question makes a study of this nature inevitable.

Difficulties encountered in obtaining data have made an independent investigation and detailed analysis of the process of privatisation in Ghana impossible in this study. As a result the study has relied mainly on available literature in a bid to unearth the intricacies of the economic concept of privatisation globally, and also to review the divestiture programme in Ghana.

To achieve this objective the study has been divided into five chapters. The first chapter provides an introduction to the study. The second and the third
chapters provide an in-depth review of theoretical and empirical literature available on the concept of privatisation. Chapter four examines the growth and development of the public sector of Ghana, whilst chapter five reviews the privatisation programme in Ghana. A brief statistical analysis is also conducted in the fifth chapter to test for the hypothesis "Average employment levels of SOEs have not changed significantly after privatisation". The last Chapter (Chapter 6) summarises the findings of the studies and the conclusions thereof.
CHAPTER 2

PRIVATISATION: A THEORETICAL REVIEW

2.1 INTRODUCTION

In order for us to put the purpose of this study into its ideal perspective, it will be proper for us to consider a background review of the topic under consideration. In the course of this review we shall be examining both theoretical and empirical studies available on the subject, in an attempt to address some of the pertinent issues involved in this study. Privatisation of course will be a meaningless concept without the prior or assumed existence of State Owned Enterprises (SOEs), hence we begin the chapter by examining the key definitions of SOEs. The definition and explanation of the key term of 'privatisation' then follows. The main techniques or methods of privatisation are the next to be discussed, followed closely by a discussion of the objectives of privatisation. The chapter continues with an examination of various ways in which privatisation is measured. Some extra detail is given to various arguments raised against privatisation in the next section, followed by an account of some constraints on privatisation. A brief summary of the chapter is presented in the last section.
2.2 DEFINITION OF SOEs

The term 'State-Owned Enterprises' or 'SOEs' is complex and does not lend itself to a single straightforward definition. As noted by Zeckhauster and Horn (1987),

SOEs are often created to meet special circumstances, and they differ significantly among themselves in several dimensions, such as independence of boards, the role of private shareholders, levels of government subsidy, and the extent to which the government is a customer. (MacAvoy et al. 1989, p11)

Three major factors contribute to the seeming complexity of defining the term SOEs. These, as noted by Zeckhauser and Horn (1987), are issues bordering on ownership, business character, and diversity of functions.

Three aspects of government ownership are likely to be particularly important. First, the government need not own all of the SOE's shares. The proportion of government ownership could vary both within and across countries, ranging from partial to full ownership. Second, there are different levels of government, which could be classified variously as, local, district, municipal, metropolitan, regional, state or provincial etc. Again, the depth of involvement of any of these levels of government will depend on the form of government in place, that is whether federal or centralised.

Further, SOEs are distinguished from other parts of the public sector by their business character and closely linked to this is the diversity of functions and the motives for their creation. SOEs are extremely diverse: they operate in a range of market environments, have markedly different histories, and are justified in many different ways. Their activities could range from the provision of essential services such as public utilities and security, to the
production of goods that can be readily sold. Whereas some typically depend on revenues from the sale of goods and services others rely on periodic budgetary grants, while freely providing their services. Zeckhauser and Horn (1987) identified four major functional areas, namely, resource preserving, resource hoarding, values promoting, and rent collecting.

The complexity notwithstanding, a definition is required that is broad enough to encompass the diversity outlined above, and at the same time narrow enough to enable us focus on the major issues to be addressed in this study.

In their attempt at finding a suitable definition for SOEs, Gillis et al (1987), identified three criteria by which an enterprise could qualify as an SOE:

1. The government is the principal stockholder in the enterprise, or is otherwise able to exercise control over the broad policies followed by the enterprise, and to appoint and remove enterprise management. This does not mean that the state must necessarily be involved in the day- to-day operations of the enterprise. Nor is majority ownership essential, because the state may effectively control an enterprise with a minority share of its equity, depending on the distribution of ownership of the other shares, and on any agreements between the government and the private partners.

2. The enterprise is engaged in the production of goods or services for sale to the public, or to other enterprises, private or public.

3. As a matter of policy the revenues of the enterprise are supposed to bear some relation to its costs. State enterprises for which profit maximization is not the prime stated objective may still qualify if they are expected to pursue profitability subject to constraints implicit or explicit in social functions assigned the enterprise by the state. (Gillis et al. 1987,p.569)

Gillis et al's (1987) definition above goes to support a previous assertion by Aharoni (1986), who also argued that, SOEs must have three distinguishing characteristics:

First.. they must be owned by the government. Second...[they] must be engaged in production of goods and services for sale....Third, sales revenue of SOEs should bear some relationship to cost. (Aharoni 1986, p.6)
For the purposes of this study therefore, SOEs shall be defined along the lines of the above analyses as a state owned entity whose principal shareholder is the government, which is engaged in the production of goods and/or services for which a price is charged and whose revenue bears some relation to its costs.

Many reasons have been cited for the proliferation of state owned enterprises. Aharoni (1986, p.4) groups them into five main categories namely, ideological, political, economic, social, and administrative reasons. Whatever the reasons however, SOEs have continued to play significant roles in the economies of the world with the degree of importance varying greatly among the various economies. According to Cook and Kirkpatrick (1988), the average contribution of public enterprises to GDP in Less Developed Countries for instance rose from 7 per cent at the beginning of the 1970s to about 10 per cent at the end of the decade. They noted further the considerable variation between countries ranging from 3 per cent in Paraguay and Nepal to 38 per cent in Ghana and Zambia. In most LDCs, the share of public enterprise investment in total gross fixed capital formation exceeds 25 per cent, and in some cases, accounts for more than 60 per cent of total investment. See Cook and Kirkpatrick, 1988, p.5
Privatisation, according to Bennet (1997) means so many things to so many people. And for this reason, a generally accepted single definition of the term may not be found. Whereas most definitions have been formulated on the basis of the methods of privatisation, others also are built around such topical issues as ownership rights. As noted by Hanke (1987):

The popularity of privatisation has different origins, reflecting different hopes that its proponents have for it. Many proponents emphasize efficiency. They see privatisation as a means to increase output, improve quality, and reduce unit costs. Others hope it will curb the growth of public spending and raise cash to reduce government debt. Others like its general emphasis on private initiative and private markets as most successful route to economic growth and human development. Finally the last group sees in privatisation a way to broaden the base of ownership and participation in a society - encouraging larger numbers to feel they have a stake in the system. (Hanke, 1987, p.3, 4)

A closer look at some of the prominent attempts at defining the term 'privatisation' will therefore be appropriate at this point. The first group of definitions centre mainly on ownership with the principal idea of ownership transfer from the public to the private sector.

- Privatisation is most commonly defined as the transfer of government-owned industries to the private sector implying that the predominant share in ownership of assets on transfer lies with private hands...privatisation is also used to cover a change from 'inside' to 'outside' contracting of government purchases and services. (Peacock, 1984 p.3-25)

- Privatisation is generally used to mean the formation of a Companies act company and the subsequent sale of at least 50 per cent of the shares to private shareholders. However the underlying idea is to improve industry performance by increasing the role of market forces. (Beesley and Littlechild, 1983, p.1-20)

- The idea involves transferring the production of goods and services from the public sector to the private sector. At its lowest common denominator, it means having done privately that which was done publicly... it is not a policy but an approach. It is an approach, which recognizes that the regulation, which the market
imposes on economic activity, is superior, to any regulation, which men can devise and operate by law. (Pirie, 1985)

- Privatisation is a term, which is used to cover several distinct, and possibly alternative, means of changing the relationships between the government and the private sector. Among the most important of these are denationalisation (the sale of publicly owned assets), deregulation (the introduction of competition into statutory monopolies) and contracting out (franchising to private firms of the production of state financed goods and services. (Kay and Thompson, 1986, p.18)

Kay and Thompson's (1986) definition is by far one of the most authoritative, with typical references to the key methods of privatisation. Subsequent definitions obviously tow the same line of description mostly bordering along the methods of privatisation. Typical examples in this category are the definitions by Cook and Kirkpatrick (1988) and Hartley and Parker (1991)

- The first and most common usage of the term refers to a change in the ownership of an enterprise (or part of an enterprise) from the public to private sector...

- A second mode of privatisation involves the liberalisation or deregulation, of entry into activities previously restricted to public sector enterprises...

- The third sense in which the word privatisation has been used is where the provision of a good or service is transferred from public to private sector, while the government retains ultimate responsibility for supplying the service. Franchising, or contracting-out of public services and the leasing of public assets to the private sector are of this form of privatisation. (Cook and Kirkpatrick, 1988, p3-4)

- Broadly defined, privatisation embraces denationalisation or selling-off state owned assets, de-regulation (liberalisation), competitive tendering, together with the introduction of private ownership and market arrangements in socialist states... (Hartley and Parker, 1991)

The process of privatisation has also been referred to in some economic literature as *divestiture*. In Ghana for example, this is by far the name by which the process is called. Divestiture, however, has generally been regarded, in terms of definition, as a narrower sense of privatisation. For example, Berg & Berg (1997, p.357) who are of this view, limit divestiture to
the sale of SOEs, going further to define privatisation in a broader sense to mean:

- Giving private actors a greater role in decisions about what, where, and how to produce goods and services. (Berg & Berg, 1997, p. 357)

Similarly, Bennet (1997) also considers divestiture (or divestment as he chose to call it), as a narrow definition, listing it as one of three broad ways of defining privatisation:

- **Divestment** by transfer of state-owned assets to private ownership, whether by sale, restitution, give-away or liquidation. (Let us call this 'P1')

- **Delegation** by transfer of management and control of state assets or activities to agents operating in accordance with market indicators, together with the introduction of private sector managerial autonomy and incentives (while maintaining state ownership and ultimate control)...(We can conveniently refer to the sum of delegation and divestment as 'P2')

- **Displacement** by passively allowing the private sector to expand, or by active promotion of private sector involvement in former public activities by contracting out (outsourcing) and by private sector provision of former public outputs, e.g. build-operate-transfer and similar projects. (The total impact of divestment, delegation, and displacement, which is the widest concept of privatisation, we refer to as 'P3'). (Bennet, 1997, p. 4)

According to Bennet (1997), the UNDP Guidelines on Privatisation (1991) characterises P3 privatisation as the *marketization* of economic activity, i.e. the subjection of microeconomic decision-making to market forces rather than to political-bureaucratic direction.

From the foregoing discussion, it becomes readily apparent that there is no commonly agreed definition of privatisation. As Wiltshire (1987) succinctly put it, 'It is an all-embracing term for several actions, all of which shift activity from the so-called 'public' sector to the 'private' sector. Like the wind, it is impossible to see and identify, but is recognised for its effects'.

21
2.4 METHODS OF PRIVATISATION

The discussion of the previous section naturally whets the desire to examine some of the recurrent methods or techniques of privatisation. One of the most authoritative volumes of literature available on the methods of privatisation is the World Bank sponsored study conducted on the topic by Vuylsteke (1988). The study identifies seven basic techniques of privatisation namely:

I. Public Offering of Shares
II. Private sale of Shares
III. Sale of Government or Enterprise Assets
IV. Reorganisation into Component Parts
V. New Private Investment in SOE
VI. Management/Employee Buy-out
VII. Leases and Management Contracts.

Vuylsteke (1988) further summarises the seven methods of privatisation and their correspondent characteristics in a table as captured in Table 1.1 below.
Table 2.1 Basic Methods of Privatisation - Summary

<table>
<thead>
<tr>
<th>Methods</th>
<th>Characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public offering of shares</td>
<td>Distribution to the general public of all or part of share in public limited company (as going concern)</td>
</tr>
<tr>
<td>Private sale of shares</td>
<td>Sale of all or part of government share holding in a stock corporation (as a going concern) to a single entity or group...can be full or partial privatisation.</td>
</tr>
<tr>
<td>Sale of government or enterprise assets</td>
<td>Sale of assets (instead of shares). Private sale.</td>
</tr>
<tr>
<td>Fragmentation</td>
<td>Reorganisation of SOE into several entities (or one holding company and several subsidiaries). Each entity will then be privatised separately.</td>
</tr>
<tr>
<td>New private investment in SOE</td>
<td>Primary share issue subscribed by the private sector (dilution of government's equity position instead of distribution of shares).</td>
</tr>
<tr>
<td>Management/employee buy-out</td>
<td>Acquisition by management and/or workforce of controlling interest in SOE. Leveraged management/employee buy-out (LMBO) consists of purchase of shares on credit extended either by seller (government) or by financial institutions.</td>
</tr>
<tr>
<td>Leases and management contracts</td>
<td>No ownership transfer. Under lease, fee is payable to owner of productive facilities, lessee assumes full commercial risk. Under Management Contract, owner pays for management skills, while manager has full management and operational control. Many variations exist.</td>
</tr>
</tbody>
</table>


The study also identifies seven major factors that will determine the procedures and methods of privatisation chosen by any particular country, namely:

1. The objectives of the government
II. The current organisational form of the SOE

III. The financial condition and the record of performance of the SOE

IV. The sector of activity of the SOE

V. The ability to mobilize private sector resources

VI. The degree of development of the capital market

VII. Socio-political factors.


Lopez-Calva identified five basic methods, namely, mass privatisation through vouchers, direct sales to strategic investors, public offerings of shares in the market, mixed sales, which is a combination of the previous two methods, and concessions. He restricted himself to the definition of privatisation as transfer of control rights from the public to the private sector that in all cases, except for concession arrangements and management contracts, involves a transfer of ownership. By so doing, his study excluded liquidation and joint ventures, as methods of privatisation, based on the argument that the former is not real privatisation, whereas the latter is just a special case in which the government retains partial control of the company. Just like Vuylsteke (1988), Lopez-Calva (1998), also identifies objectives of governments, political and institutional constraints, and market structure as the primary determinants of the methods of privatisation to be selected.

Going by a more theoretical approach, Pirie (1988) extensively discussed twenty-one methods of privatisation as listed below:

1) Selling the whole by public share issue
2) Selling a proportion of the whole operation
3) Selling parts to private buyers
4) Selling to workforce or management
5) Giving to workforce
6) Contracting out the service to private business
7) Diluting the public sector
8) Buying out existing interest groups
9) Charging per service
10) Setting up counter-groups
11) Deregulation via private associations
12) Encouraging alternative institutions
13) Making small-scale trials
14) Replacing monopolies to let competition grow
15) Encouraging exit from state provision
16) Using vouchers
17) Admitting demand pressures
18) Curbing state powers
19) Applying closure proceeding
20) Withdrawal from the activity
21) The right to private substitution.
(Pirie, 1988, pp. 69-252)

However, the World Bank Technical Papers No. 88, No. 89 and No. 90 give a most extensive insight into the techniques of privatisation of SOEs. These publications address methods and implementations; selected country case studies and inventory of selected country experiences respectively. For details, see Vuylsteke (1988), Nankani (1988) and Candoy-Sekse (1988).

2.5 OBJECTIVES OF PRIVATISATION

As already noted in the previous chapter, privatisation has become a major component of most structural and/or economic reform programmes in both developed and developing countries. The objectives of governments undertaking privatisation vary widely with various degrees of emphasis. According to Vuylsteke (1988), privatisation may meet several objectives simultaneously, which will become intertwined in one programme. However
the relative importance of a country's objectives will influence both the choice of the SOEs to be privatised and the methods to be applied. The most important objectives usually highlighted by both policy makers and researchers alike include among others:

I. To improve economic efficiency
II. To increase revenue to the government
III. To reduce burden on the budget
IV. To introduce market economy
V. To establish democracy
VI. To improve consumer welfare
VII. To widen share-ownership and popular capitalism
VIII. To reduce public sector borrowing
IX. To control trade union power.

Bennett (1997) roughly categorized these objectives into four identifiable groups as follows:

- **Political goals** such as reducing the size of the public sector, restoring or strengthening the private sector (as in all transitional economies), spreading share ownership more widely (popular capitalism), and making productive enterprises more responsive and accountable to those for whom they produce;

- **Efficiency goals** such as increasing productivity and microeconomic efficiency. The development of capital market institutions, which intermediate between savers and investors, may also be classed as an efficiency objective;

- **Fiscal stabilization goals** such as maximizing proceeds of sales, reducing the future drain of subventions and capital contributions from government revenue, increasing tax revenues from higher profits and reducing the public debt;

- **Resource mobilization goals** such as promoting foreign investment in the country, releasing limited state resources for investment in other sectors such as education and health. (Bennett, 1997, pp. 7-8)
These goals, Bennett agreed, are pursued unevenly, with one or the other predominating at any time.

On the other hand, Hartley and Parker (1991) contend that some of the objectives enumerated above sometimes tend to be in conflict. They argue for example that, reducing the size of the public sector and/or maximizing treasury income from selling public assets may not be compatible with the goal of efficiency if it involves transferring monopoly power from the public to the private sector without increasing competition and rivalry, or maximizing the number of shareholders, which might require underpricing of shares, and might conflict with efforts to maximize treasury income. This assertion is further buttressed by Mohnot's (1997) paper on Indian privatisation, which reveals the confusion and lack of consistent direction that can result from a lack of clarity of objectives⁴.

It is worthy to note, however, that for most developing countries, privatisation may not be so much of an end in itself, but rather a means to achieving wider economic objectives. It is an integral part of the wider Structural Adjustment Programmes (SAPs) or Economic Recovery Programmes virtually pushed down their throats by the Bretton Woods institutions, notably the World Bank and the IMF, as for instance is the case in Ghana⁵. Besides the common objectives enumerated above, many developing countries perceive privatisation as a means of dealing with foreign debts (comparable to the budget deficits that western governments

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⁴ See also Sheshinski & Lopez-Calva (1999)
⁵ Ghana's Divestiture Implementation Programme Fact Sheets (2000)
face), and also as a means of attracting new foreign investment. See van Dijk & Nordholt, 1994, pp.8.
<table>
<thead>
<tr>
<th>Study/Publication (Author, year, pages)</th>
<th>Context</th>
<th>Objective is to:</th>
<th>Improve Economic efficiency</th>
<th>Increase Revenue/ Decrease burden to treasury</th>
<th>Introduce market economy/ Establish democracy</th>
<th>Improve consumer welfare</th>
<th>Promote Popular Capitalism</th>
<th>Reduce Public Sector Borrowing</th>
<th>Solve Management problems</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ferguson * (1988, pp. 163)</td>
<td>The UK</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Rapacki (1995, pp. 57-74)</td>
<td>Poland</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Okano (1990, pp. 145-156)</td>
<td>Japan</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Tomic (1991, pp. 36-39)</td>
<td>USA</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wessels (1995, pp. 53)</td>
<td>USA</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Salam (1996, pp. 86-89)</td>
<td>Pakistan</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Kikeri et al. (1992, pp. 13)</td>
<td>Developing Countries</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yarrow (1986, pp. 327)</td>
<td>The UK</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Bishop et al. (1994, pp. 1-6)</td>
<td>The UK</td>
<td>X</td>
<td>X</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>
Table 2.2 Summary of Aims and Objectives of Privatisation (cont’d).

<table>
<thead>
<tr>
<th>Study/Publication (Author, year, pages)</th>
<th>Context</th>
<th>Objective is to:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Improve Economic efficiency</td>
</tr>
<tr>
<td>Kay &amp; Thompson * (1986, pp. 19-29)</td>
<td>The UK</td>
<td>X</td>
</tr>
<tr>
<td>Commender &amp; Killick (1991, pp. 96-124)</td>
<td>Developing Countries</td>
<td>X</td>
</tr>
<tr>
<td>Hartley &amp; Parker (1991, pp. 11-12)</td>
<td>Conceptual</td>
<td>X</td>
</tr>
<tr>
<td>Clark et al. (1996, pp. 395-406)</td>
<td>USA</td>
<td>X</td>
</tr>
<tr>
<td>Sonko (1994, pp. 1083-1096)</td>
<td>Swaziland</td>
<td>X</td>
</tr>
</tbody>
</table>

NOTE: * These studies recognised disciplining trade unions as one of the objectives.

Liyanage (1998) presented a summary of the aims and objectives of
privatisation as captured in table 2.2 above, analysing various studies against
the background of varying degrees of emphasis for the countries involved.
From the table, it becomes evidently clear that efficiency goals remain
prominent in all studies and with all countries. This, Liyanage (1998)
concludes, supports the argument that the primary objective of privatisation is
to improve the efficiency of SOEs.

2.6 MEASUREMENT OF PRIVATISATION

As already discussed in the preceding sections, privatisation means so many
things to so many people, with multiplicity of aims and objectives. Dijk and
Nordholt (1994) argued that, although privatisation is not a panacea that
works under all circumstances and is successful in any branch of industry, it
appears that there exists hardly any consensus as to how to assess the
results of privatisation policy measures. One of the main reasons, they
noted, seems to be that although the objectives of privatisation contain both
economic and political motives, the International Donor Community is
formally bound to be politically neutral, hence, only to apply economic criteria
in measuring the progress of privatisation processes. This leads to political
objectives being either implicitly assessed, or, even worse, evaluated on
economic criteria. Another major reason, they noted, is the fact that
statements on successes or failures of privatisation policies are mostly based
only on scarce empirical data. The normative imperatives for privatisation
seem to be so dominant that valid and reliable empirical data comes second.

Moreover, hardly any clear distinctions are made between different modes and types of privatisation processes, making conclusions drawn from such ‘comparative studies’ rather questionable.

In the light of these difficulties, Bennett (1997) suggested that it is better to define concepts so that they can be measured.

What is meant when it is said that Chile has gone furthest in privatising its economy, and how do we settle the rival claims of the UK, of New Zealand or of Jamaica? We need a conceptual framework for analysis of privatisation processes and agreed measures for reporting them, both in the context of the systemic transformation going on in the former centrally planned economies and, equally, in the developing (mixed) economies. What measures are we using and what significance can be attached to them? When one can measure something, one has the beginning of a science. Figures of speech become figures of arithmetic. It becomes possible to say, for instance, whether something has increased or decreased, and by how much and to relate effects to causes.

(Bennett A. (1997) pp 3-4)

Bennett (1997) proceeded to suggest three alternative measures of privatisation briefly discussed as follows:

a) Number of State-Owned Enterprises (SOEs) sold or otherwise transferred into private ownership. This measure is mainly applicable where the definition of privatisation is restricted to the divestment of ownership of state-owned enterprises. But then SOEs range enormously in size and cannot simply be added up, and in some cases have to be broken up into separate businesses to make them more saleable. The concept is also limited in that it does not cover transfers of other state-owned assets, such as government land, housing and pension funds.
b) **Total proceeds of sale accruing to the government treasury.** This amount can be put into perspective by relating it to national parameters such as GDP. Where the main objective of privatisation is fiscal relief, it could be argued that the share of privatisation proceeds in total revenue would be a very significant ratio. There are some limitations with this concept however: 1) political factors such as the price (which is often set low and could be nil in a coupon privatisation, 2) any monopoly rents allowed to the enterprise and other policy sweeteners, and 3) the extent of liabilities transferred with the assets.

c) **The share of the private sector in the economy.** Bennett (1997) contends that the most comprehensive measure of privatisation in its broadest definition is the share of private entities in the production of the GDP, and the rate of privatisation is best assessed by the rate of change of this share. This represents the share of private entities in the creation of all value added coming from resource management in the country, both public and private. It captures the more rapid growth of private enterprises, compared with the public sector, which results from constraints on public sector growth on the one hand and from private sector development policies on the other.

It is necessary to note at this point that most of the available studies on privatisation have applied a combination of either two or all three of the above concepts in measuring the process of privatisation in various
countries\textsuperscript{6}. A recent World Bank study (1995) uses SOE share in GDP, rather than private share in GDP, as its principal measure. But this is considered technically inferior as a measure of privatisation as it omits all privatisation by delegation.

\textbf{2.7 ARGUMENTS AGAINST PRIVATISATION}

That Privatisation has very notable benefits cannot be gainsaid. In section 2.5, we examined the objectives of Privatisation, which by and large embrace the advantages and for that matter the arguments usually raised in favour of this well acclaimed economic policy. It also came out clearly from that section that improved economic efficiency in the performance of divested firms remains the foremost goal of privatisation. However, like any other economic policy, Privatisation has not gone without its fair share of criticism. Some pertinent arguments have been raised in economic literature that seek to rationalise the continuous intervention of government in the market place, and these we now examine as follows:

\textbf{2.7.1 The Primary Objectives of Establishing SOEs}

It is the view of many a critic that the very fundamental reasons for establishing the SOEs, if critically examined, will give credibility to the call for their sustenance. Although there are multiples of such objectives, we shall

for the purpose of this study analyse them under three significant headings (borrowed from Gillis et al, 1987) as below:

A. Economic reasons:

- *Savings mobilisation* has been one of the longest standing and most frequently employed rationales for creating SOEs. According to Gillis et al (1987), even when decisions to establish SOEs have been motivated by other factors, savings mobilization has often been mustered as supplementary argument. The argument is normally that; domestic capitalists (particularly in Less Developed Countries), generate too little savings because they are conspicuous consumers. Moreover, those savings generated by domestic capitalists are often invested abroad. Again, in most developing countries, public savings cannot adequately finance capital formation because low levels of per-capita income and weak public administration make it particularly difficult to raise tax revenues. This view is equally shared by Nafziger (1990), and also Cook and Kirkpatrick (1988), who concluded that, where the growth of the economy is constrained by inadequate savings, the public enterprise sector may be seen as a potential source of investible surplus.

- *Employment objectives* have also featured prominently in the establishment of public enterprises. Again, Gillis et al (1987) observed that in most instances the goal has been defined as the creation of new jobs as the economy and the firm expand. In other cases the focus has been upon job preservation, as large, ailing, private firms
have been taken over by the government in order to avoid the unemployment consequences of potential bankruptcies. See also Cook and Kirkpatrick, (1988, pp6-7)

- *Capital lumpiness*, as noted by Gillis et al (1987), has been an argument for public enterprise in countries where money and capital markets are not well developed, so that private domestic firms have been unable to mobilise the volumes of capital necessary to mount large, capital-intensive projects. This view is supported by other writers as follows:

  Public enterprise may be a pragmatic response to economic problems, such as the need to eliminate, reduce or control a monopoly or to ensure an adequate supply of essential goods and services at reasonable prices when excessive financial and technical risks deter private sector investment or in cases where the private sector is not able to deliver what government feels is required in the public interest.

  (Aharoni, 1986, pp 4)

Where private sector activity is constrained by high risk aversion, poorly developed financial markets or paucity of information, 'entrepreneurial substitution' has been a motive for establishing public enterprises. Second, in economies characterised by limited integration between different sectors, public investment can perform the role of ensuring that the conditions necessary for industrial growth are met. Thus...the need to accelerate the process of industrialization has led to public sector participation in sectors believed to have significant linkage effects.

  (Cook & Kirkpatrick, 1988)

Finally, the point made by Ghana's Dr. Kwame Nkrumah, Africa's most radical nationalist leader in the 1950s and early 1960s underscores the importance of the economic rationale for establishing SOEs, especially in the less developed countries:

  I must make it clear that these state enterprises were not set up to lose money at the expense of the taxpayers. Like all
business undertakings, they are expected to maintain themselves efficiently, and show profits. Such profits should be sufficient to build up capital for further investment as well as to finance a large proportion of the public services, which it is the responsibility of the state to provide. (Dr. Kwame Nkrumah)\textsuperscript{7}

B. Socio-political reasons:

- \textit{Commanding heights} is a term applied to sectors of the economy that are so strategic and generate such linkages that they cannot, it is argued, be left in private hands, whether foreign or domestic. See Gillis et al, 1987. Explaining this further, the writers noted that the commanding heights can be a rather elastic concept, but generally includes basic industries, such as mineral extraction and processing, iron and steel making, chemical manufacturing, electricity generation, rail service, and such crucial services as banking. Dijk and Nordholt (1994), on the other hand observed that, sometimes in the field of innovative and pioneering activities, the government may establish enterprises based on economic considerations so as, for example, to stimulate the growth of a specific sector such as tourism. See also Cook and Kirkpatrick (1988, pp6-7).

- \textit{Decolonialization} is very much related to the commanding heights motive. Many countries formerly under the domination of a colonial power have viewed the continued presence of colonial industrial interests as a bitter reminder of the past and a major impediment to development. Gillis et al (1987) noted that many developing countries,

\textsuperscript{7} Kwame Nkrumah, Revolutionary Path (New York: International Publishers, 1973), p.37,
both socialists and non-socialist, have had to nationalize foreign interests in the late 1950s and early 1960s in pursuit of this policy of decolonialization. Cook and Kirkpatrick (1988) on the other hand relate this to ideological motives and argued thus:

In some cases, public ownership has been pursued for ideological reasons, with public ownership of the means of production being seen as a necessary condition for the establishment of socialism and, therefore, advocated as an end in itself. In other instances, public ownership is perceived as a necessary counterweight to foreign ownership and influence in the economy.

(Cook & Kirkpatrick, 1988)

Gillis et al (1987) concluded that, in almost all cases, the shortage both of capital and of trained indigenous managers has meant that ownership of the nationalized enterprises could not immediately pass to the domestic private sector, but devolve to the state.

This rationale accounts for perhaps three-quarters of the nearly two hundred government-owned enterprises now operating in Indonesia, primarily expropriated from Dutch interests in 1957 and British interests in 1962; for a large number of Egyptian SOEs created in 1957 when, after the Suez war, Nasser nationalized important foreign firms; and for a significant share of public enterprises in Ghana and Algeria...

(Gillis et al 1987, pp573)

- Social goals have also led to the creation of many SOEs. Cook and Kirkpatrick (1988) argued that, in some cases, some of these SOEs were established and used as an instrument for the pursuit of distributional goals. The public enterprise may be used to create or preserve employment (already noted as an economic goal), or may be used as a counterweight to the concentration of private economic

from a 1964 speech.
power, or to strengthen the economic position of particular ethnic
groups or geographical regions. Supporting this argument are Dijk
and Nordholt (1994), and also Gillis et al (1987), who concluded that
although few public enterprises owe their existence entirely to
government's social or equity goals, in recent years a number of
enterprises have been established principally for purposes of rectifying
imbalances between social groups and between regions of a country.

C. Mixed reasons:

- Concentration of economic power in the hands of a small section of
  society has led to some governments nationalizing some private
domestic firms in a bid to reduce the scope of abuse of such power.
In the case of Ghana before independence, Etukudo (2000) noted that
the country's economy consisted of three levels: at the top were the
Europeans and the Levantines owning the large commercial
enterprises; in the middle were the Asians and the Middle Easterners
engaged in wholesale and retail trading with virtual monopoly over
general transport services including motor spare parts; at the bottom
were the Africans pursuing farming, petty trading and rudimentary
services. Following the numerous coup d'états that had characterised
the politics of the country, many of these private assets have had to be
nationalised under the guise of bridging the gap between the rich and
poor. Finally, Gillis et al (1987) cited the examples of Pakistan, Chile,
and Peru where some private concerns had to be seized on the

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grounds of excessive concentration of ownership in the hands of a small number of individuals and families.

- Preferences of some foreign aid donors have also played a part in the creation of SOEs in most countries. Gillis et al (1987) noted that, the World Bank, particularly since 1967, and the Asian, African and Latin American Development Banks have preferred to channel large portions of their resources through SOEs rather than through ordinary government agencies or private enterprises in Less Developed Countries (LDCs).

2.7.2 Market Failure and the Economic Roles of Government

Under this subsection, we shall attempt to discuss some of the salient economic arguments usually raised in support of government intervention and for that matter state sector involvement in economic activities. For the sake of clarity of description, we shall begin by taking a brief look at the main economic roles assigned to government. We shall then examine the nature and causes of market failure, before finally settling on the basic conditions for government intervention.

A. The Economic Roles of Government:

Economists have so far identified four primary functions that are by all indications inextricable from government.

- The Allocative Role. This is the situation where government pursues that allocation of resources which maximises efficiency. This is generally referred to as allocative efficiency or the 'first best' allocation of resources.
The government has to deal with the market distortions caused by monopoly power and other forms of 'market failure'. See Bailey (1995). In other words, it is the shifting of resources into preferred (and out of nonpreferred) areas. See also Marlow, (1995). Musgrave & Musgrave (1989) on the other hand described this function as the provision of social goods, or the process by which total resource use is divided between private and social goods and by which the mix of social goods is chosen and this they contend, comes out as a budget policy.

• **The Distributive Role.** Where the government balances efficiency with equity in the allocation of resources by using taxation, social security and the distribution of public sector services to influence the distribution of income. See Bailey (1995). Or the changing of the final recipients of goods and services produced by the economy, the final goal of which is to provide an equitable distribution of income. See Marlow (1995).

• **The Regulatory Role.** Where the government legislates and enforces laws of contract, consumer protection, justice and so on, in order that the market economy may function. See Bailey (1995). In other words, it is the setting up of the legal framework that establishes the rules of the economic game played by households, firms, and even governments. Such rules include the definition of property, the laws of contracts and business enterprise, the mutual obligations of labour and management, and a multitude of statutes constraining the way different members of the society interact. See Samuelson & Nordhaus (1989). Marlow (1995), on
the other hand called it the *protection role* of government, embracing the safeguarding of the personal property and rights of individuals by the public sector.

- *The Stabilization role.* Whereas the allocative, distributive and regulatory roles are microeconomic in nature, the stabilisation role is macroeconomic in using fiscal, monetary, and other economic policies to pursue objectives for the control of inflation, unemployment etc. See Bailey, 1995\(^9\). Or the use of budget policy as a means of maintaining high employment, a reasonable degree of price level stability, and an appropriate rate of economic growth, with allowances for effects on trade and on the balance of payments. See Musgrave & Musgrave (1989). Or simply put, the act of monetary and fiscal policymakers who attempt to smooth out the ups and downs in the economy. See Marlow (1995).

It should be noted however that, these four roles interact with each other. For example fiscal policy intervention under the stabilisation role involves changes to taxation and public expenditure that affect the distribution of income in cash and in kind.

B. Market Failure:

Haveman (1976) has defined *market*, in the private economy, as any arrangement that makes possible the exchange of money for goods and services or money for factors of production. They are the crucial connecting

link in the private sector of the economy. In the markets, exchanges are made, prices are formed, and incomes, costs, and revenues are determined. Markets link buyer to seller, household to business, and provide the channel through which the circular flow of money, factor services, and commodities passes. Baumol et al (1992) refers to it as a set of sellers and buyers whose activities affect the price at which a particular commodity is sold. Lipsey and Chrystal (1995) on the other hand summed up the characteristics of market economies as: 'markets co-ordinate decentralised decision-taking; markets function without conscious central direction; in allocating resources, markets also determine the distribution of income; the long-term behaviour of markets often exhibits a cycle in which products are born, grow to maturity, pass into old age, and eventually die'.

Notwithstanding the above definitions, a number of conditions must be met if the private sector of the economy (the market system) is to function efficiently. Indeed, these conditions are essential if the private sector is to perform in the public interest and also meet the pareto efficiency criterion which characterises resource allocation in which no individual can be made better off without making any other individual worse off. See Haveman (1976), and also Marlow (1995). Economists have identified six basic conditions, the absence of which gives rise to demands for public sector (government) intervention:

1. Perfect Competition
2. Increasing Costs
3. The Exclusion Principle
5. Complete Knowledge or Perfect Information
6. Complete Mobility or Perfect Resource Allocation

This now brings us to the definition of market failure and the basic factors or conditions for government action.

**Market failure**, according to Brown and Jackson (1986), refers to those situations in which the conditions necessary to achieve the market efficient solution fail to exist or are contravened in one way or another. Lipsey and Chrystal (1995) described it as any market performance that is judged to be less good than the best possible performance. It means that the best attainable outcome has not been achieved. It does not mean that nothing good has been achieved. Brown and Jackson (1986) further noted that, left to itself, the market system of any economy is unlikely to operate efficiently. There will be a tendency for it to produce too much of some goods and an insufficient amount of others. In the extreme case of market failure the market will fail to exist, so that certain goods will not be produced at all.

Flowing from the discussion above, we shall now turn to the individual factors that bring about the failure of markets to achieve efficient outcomes, even as we examine the extent to which they stimulate government intervention in the market place. These factors include: Public Goods, Externalities, Natural Monopolies (decreasing costs), Incomplete Information, Uncertainty, Moral Hazard, Rent seeking, and Absence Of Property Rights. The first three however are of prime interest to this study.
• *Public Goods* are described by Baumol et al (1992) as commodities that are valuable socially but whose provision cannot be financed by private enterprise. Again, they are commodities or services whose benefits are not depleted by an additional user and for which it is generally difficult or impossible to exclude people from its benefits, even if they are unwilling to pay for them. Thus, government must pay for public goods if they are to be provided at all. Lipsey and Chrystal (1995), on the other hand describe them as collective consumption goods for which the total cost of production does not increase as the number of consumers increases.

Public goods are ones whose benefits are indivisibly spread among the entire community, whether or not individuals desire to purchase the public good. Private goods, by contrast, are the ones that can be divided up and provided separately to different individuals, with no external benefits or costs to others. Efficient provision of public goods often requires government action, while private goods can be efficiently allocated by markets. *(Samuelson & Nordhaus, 1989, pp. 771)*

Notable examples of a public good are, defence, police protection, or the services of lighthouses. There are some notable characteristics of the public good that do not only distinguish it from the private good, but also go to buttress the point for government provision:

➤ Non-excludable – It is not possible to prevent use of the service by those who do not pay for it (producers therefore being unable to recover costs)

➤ Non-rival in consumption – One person’s consumption of the commodity does not affect any other person’s consumption of it.

➤ Zero marginal costs – Because public goods are non-rival in consumption, the marginal cost of providing these goods to additional
citizens are zero. For example, the cost of allowing one more citizen to enjoy the benefits of a well protected nation or to let one pilot use the warning lights on mountains are nothing.

- Non-depletable – One person’s consumption does not deplete the supply available for other people, either temporarily or permanently.

To summarise: It is usually not possible to charge a price for a (pure) public good because people cannot be excluded from enjoying its benefits. It may also be undesirable to charge a price for it because that would discourage some people from using it even though using it does not deplete its supply. For both these reasons, we find governments supplying many public goods. Without government intervention, public goods simply would not be provided. (Baumol et al, 1992, pp.689)

Whilst the above features tend to distinguish between pure public goods and pure private goods, economists have also identified some ‘middle of the road’ goods, which they have variously classified as Mixed Goods, and Merit Goods. Tables 2.3, and 2.4 below set out the detailed features of these goods.

- Externalities. The argument here is that, the private sector sells many commodities that affect people other than the purchaser. Social costs and benefits extend beyond the purchaser’s private costs and benefits and so are external to market prices. These ‘externalities’ lead to allocatively inefficient decisions even if individuals are the best judges of their own welfare and even if perfect competition exists.

    An externality or spill over effect occurs when production or consumption inflicts involuntary costs or benefits on others; that is, costs or benefits are imposed on others yet are not paid for by those who impose them or receive them. More precisely, an externality is an effect of one economic agent’s behaviour on another’s well-being, where that effect is not reflected in dollar or market transactions. (Samuelson & Nordhaus, 1989, pp. 770)
There are two sides to externalities; the positive (beneficial) externality, and the negative (harmful) externality.

Positive externality occurs for example, when a resident paints his house and enhances his neighbours' view and the value of their property, or when a scientist invents a work of art whose worth is far in excess of what he was paid to produce it. Firms will turn to produce less than the socially optimal level of output whenever their products generate beneficial externalities, because they bear all the costs while others reap part of the benefits. Such benefits are external to the market and therefore are not incorporated in demand schedules.
Table 2.3: A Taxonomy of market failure (A)

<table>
<thead>
<tr>
<th>Type of commodity</th>
<th>Pure Public Good</th>
<th>Mixed Goods* With externalities</th>
<th>Merit Goods</th>
<th>Pure Private Goods</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Who benefits?</strong></td>
<td>All in society</td>
<td>Consumers and society</td>
<td>Individual consumers</td>
<td>Individual consumers</td>
</tr>
<tr>
<td><strong>Exclusion of non-tax payers</strong></td>
<td>Technically Impossible</td>
<td>Difficult or impossible</td>
<td>Feasible</td>
<td>Feasible</td>
</tr>
<tr>
<td><strong>Feasibility of Pricing</strong></td>
<td>Not feasible</td>
<td>Feasible</td>
<td>Feasible</td>
<td>Feasible</td>
</tr>
<tr>
<td><strong>Consumer choice</strong></td>
<td>None</td>
<td>Some</td>
<td>Full</td>
<td>Full</td>
</tr>
<tr>
<td><strong>Impact of use On supply</strong></td>
<td>None</td>
<td>Depletes supply</td>
<td>Depletes supply</td>
<td>Depletes supply</td>
</tr>
<tr>
<td><strong>Who pays on Efficiency grounds?</strong></td>
<td>The taxpayer Only</td>
<td>Consumers pay prices adjusted by taxes or subsidies**</td>
<td>Consumers pay prices subsidised by taxpayers</td>
<td>Consumers pay full costs</td>
</tr>
<tr>
<td><strong>Relationship between payment and use</strong></td>
<td>None</td>
<td>Close</td>
<td>Close</td>
<td>Full</td>
</tr>
<tr>
<td><strong>Who decides whether to produce?</strong></td>
<td>Government only</td>
<td>Modified market</td>
<td>Modified market</td>
<td>Market only</td>
</tr>
</tbody>
</table>

Notes:
* Having elements of both public and private goods
** Taxes in the case of negative externalities; subsidies in the case of positive externalities.

SOURCE: Bailey, S.J, 1995, (Public Sector Economics; Theory, Policy, and Practice, pp.29)
### Table 2.4: A Taxonomy of market failure (B)

<table>
<thead>
<tr>
<th>EXCLUDABLE</th>
<th>NON-EXCLUDABLE</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Pure Private Goods</strong></td>
<td><strong>Mixed Goods</strong></td>
</tr>
<tr>
<td>1. Exclusion costs are low</td>
<td>1. Goods whose benefits are collectively consumed but which are subject to congestion or crowding</td>
</tr>
<tr>
<td>2. Produced by private firms</td>
<td>2. Produced by private firms or directly by the public sector</td>
</tr>
<tr>
<td>3. Distributed via markets</td>
<td>3. Distributed via markets or directly via public budgets</td>
</tr>
<tr>
<td>4. Financed out of revenues from sales</td>
<td>4. Financed out of revenues from sales, eg. Fees for the right to use the service, or financed from tax revenues</td>
</tr>
</tbody>
</table>

*Examples: Food, shoes, Theatre, cable TV, golf course, swimming pool, public park.*

<table>
<thead>
<tr>
<th>NON-RIVAL</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mixed Goods</strong></td>
<td><strong>Pure Public Goods</strong></td>
<td></td>
</tr>
<tr>
<td>1. Private goods with externalities</td>
<td>1. High exclusion costs</td>
<td></td>
</tr>
<tr>
<td>2. Produced by private firms</td>
<td>2. Produced directly by government or by private firms under contract to government</td>
<td></td>
</tr>
<tr>
<td>3. Distributed via markets with subsidies or corrective taxes</td>
<td>3. Distributed via public budget</td>
<td></td>
</tr>
<tr>
<td>4. Financed by revenue from sales</td>
<td>4. Financed out of compulsory tax revenue</td>
<td></td>
</tr>
</tbody>
</table>

*Examples: Schools, transport systems, health services, inoculations, National defence.*

The demand schedule in Figure 2.1 measures willingness to pay, that is, the marginal private valuation (MPV) for the commodity. The marginal social valuation (MSV) exceeds the MPV and so the private optimal output $q_1$ is less than the social optimal output $q_2$. Hence allocative inefficiency exists. Government subsequently intervenes in two possible ways: a) by compulsion, b) by subsidising the price paid by customers in order to increase the demand to the optimal level.

- Negative externality occurs for example, when a factory generates smoke (pollution). Individuals who live and work in the neighbourhood bear real costs arising from the factory’s production: the disutility of enduring the smoke (pollution), of
adverse health effects, and of clean-up costs. The factory owners will not take these effects into account when they decide how much to produce. The element of social cost that they ignore is external to their decision-making process. Producers who create harmful externalities will produce more than the socially optimal level of output.

Figure 2.2: Negative externalities

Since social costs are external to private costs they are not passed in higher product prices. Prices are therefore too low (in relation to marginal cost) and so consumption and demand are too high. This results in allocative inefficiency. This case is shown in Figure 2.2 above, which includes both private and social marginal costs (MC and SMC respectively). The demand
schedule is horizontal because perfect competition is still assumed to exist. For ease of exposition, the average cost curve is not shown. SMC lies above MC, showing that a given level of output q1 has a social cost c2 greater than private cost c1. The value of the negative externality is c2-c1. The market equilibrium is q2 (where MR=MC) but the social optimum output is only q1. Hence there is excess production of q2-q1, so that allocative inefficiency exists. Government intervention therefore becomes obvious and the main options available are; a) to pass legislation prohibiting the economic activity causing the problem, or, b) tax the negative externality.\(^{10}\)

- **Natural Monopolies** are industries in which the advantages of large-scale production make it possible for a single firm to produce the entire output of the market at lower average cost than a number of firms each producing a smaller quantity. A natural monopoly need not be a large firm if the market is small enough. What matters is the size of a single firm relative to the total market demand for the product.

There are two basic reasons why a monopoly may exist: barriers to entry, such as legal restrictions and patents; and cost advantages of large-scale operation, such as those that lead to natural monopoly. (Baumol et al, 1992, pp 636-637)). Natural monopolies are frequently referred to as increasing returns to scale or decreasing cost industries. The feature of an increasing cost industry is that as output expands, long run average cost curve (LAC) tends to decline as shown in Figure 2.3 below. If LAC declines, long run marginal cost (LMC), by definition

should lie below LAC. Following the efficient pricing rule, price is set at \( P_c \) with the corresponding quantity \( Q_c \). The total revenue to the firm is \( OQ_c A P_c \), which is less than the total cost of \( Oq_c B P_r \). The profit-maximizing producer does not meet this condition. Government thus intervenes with either of two options: a) subsidise the producer by \( Oq_c B P_r - Oq_c B P_r = P_c A B P_r \), or b) take over the entire production and subsidise the SOE with taxes. Whichever option is employed, cost of subsidies has to be met by government revenues, which comes mainly form taxes. Natural monopolies thus strengthen the argument for the allocative role of government. See Brown & Jackson, (1986, pp.34-36). Many public utility firms (such as suppliers of water and electricity) operate as monopoly suppliers for the reasons outlined above. It is believed that the technology of producing or distributing their output enables them to achieve substantial cost reductions when they produce large quantities. It is therefore often considered desirable to permit these firms to obtain the lower costs they achieve by having the entire market to themselves, and to place them under government control, rather than break them up into a number of competing firms. See Baumol et al, (1992), pp.636-637.
Figure 2.3: Natural Monopoly

D = Demand curve
MR = Marginal Revenue
LAC = Long-run cost
LMC = Long-run marginal cost
Pm = Price in monopoly
Pc = Price in the competition
Qm = Quantity supplied in the monopoly at price Pm
Qc = Quantity supplied in the competition at price Pc
Pm > Pc and Qm < Qc

The apparent detail given to this section is deliberate. The essence is to provide a theoretical background for the empirical debate on the efficiency concept in the next chapter.
Although the process of privatisation has been smooth and rapid in the
developed countries, the same cannot be said about the programme in the
Less Developed Countries (LDCs), and the former socialist countries
(planned economies). Before we draw this chapter to a close however, it will
be appropriate to examine some of the practical implementation problems
associated with the slow pace of privatisation in these countries:

1. Lack of finance and absence of capital markets: The domestic
   population in most of these countries, as noted by Kikeri et al, (1992),
   is illiquid. The banking and credit system is in desperate shape, and
   the only likely domestic buyers are the members of the distrusted and
discredited upper class. Moreover, most of these countries have very
weak financial systems. An example is given of Ghana, where the five
   major banks had a total of $2.1 million for acquisition financing, while
   the estimated value of the SOEs up for sale in the first round
   exceeded $25 million, that is, more than the total worth of the banks.
The situation is made worse by the absence of capital markets that
   are sufficiently well developed to handle equity sales. See Kirkpatrick
   (1989). This means that divestiture will have to be made by direct
   placement with local or foreign interest; a gesture that most
governments may wish to avoid, for reasons already noted above.

2. Clarity of objectives: Clarity of objectives and strategy are essential
   for the success of privatisation. This involves identifying and resolving
   policy tradeoffs; establishing the appropriate scope, pace and
sequencing of privatisation; and choosing the right methods. See Kikeri et al (1992, p.14). However, as noted by Dijk, (1994), there is lack of conceptual clarity what the purpose of privatisation is: which phases or functions would have to be privatised. In some cases, enterprises offered for sale are haphazardly chosen; with very poor preparatory work, and a general exclusion of the private sector from the whole process. See Berg, (1993).

3. Lack of political will: Despite the pro-private sector declarations, which reflect a genuine shift in attitude at the political level, many responsible officials remain nonchalant and suspicious towards potential buyers. Also, some governments are not very eager to sell some state-owned enterprises; particularly the more profitable ones. As noted by Commander & Killick (1988), where public enterprises are profitable the rationale (and perhaps the motivation) for divestiture is diminished if the reduction of public deficits is the core objective. Moreover, most of these governments are still struggling with democracy and other transitional problems. The leaders simply lacked the political will-power, (mainly for fear of losing votes), to carry out the necessary liberalisation of prices, trade, interest and wage rates that normally accompany privatisation. Such reforms, they fear, may bring in their wake the collapse of the industrial base, high levels of unemployment, inequities in the distribution of property, and grievous socio-political disruption. There is also a general unwillingness to accept the current policy priorities of the international agencies, and the accompanying
cohort of international merchant banks and managerial consultancy firms. See Kikeri et al (1992), and also Kirkpatrick (1989).

4. **Vested Interests:** The vested interests arrayed against privatisation are powerful. There is political interference at various levels. For example, political considerations are most often applied in deciding a bidder's acceptability. Real or presumed political objections affect the execution of several deals, the end result being undue delays in executions. There are bureaucratic and business elites, who want to make the most personal gains from the privatisation process. See Berg (1993). There are also opposition political groups who are simply out to score political points. But the most important form of resistance is from interest groups that stand to lose from privatisation. This opposition will come from the labour force employed in the public enterprises, who fear job losses. Also, where liberalisation is threatened, further resistance will come from those groups who currently enjoy the protected economic rents created by the system of regulations and controls.

5. **Weak Legal/regulatory framework:** For most of these countries, the legal basis for private ownership is unclear or embryonic and the claimants to property rights are numerous and competing. However, as observed by Kikeri et al, (1992), legal issues permeate the whole privatisation process, from preparation to implementation and follow-up. Privatising countries do not only need to have the necessary legal framework in place, but also qualified, experienced, and
independent lawyers to help with the identification of critical legal
issues and promising solutions.

6. **Valuation Problems:** Experience has shown that even with the
developed countries where there is a sophisticated financial
infrastructure, it is still difficult to establish the appropriate value for the
enterprise assets. With the LDCs, the problem is further compounded
by long delays at the valuation offices as well as inappropriate
valuations characterised by replacement cost instead of market value.
Ghana is an example. See Berg (1993); Kirkpartrick (1989); Dijk
(1994). Very often the elaborate auditing, consulting, and financial
apparatus for preparing a firm for sale must be built from scratch or
imported at high cost.

7. **Potential Profitability of firms:** Commander & Killick (1988) noted
potential profitability as not only fundamental in determining the nature
and pace of divestiture, but also in part a function of the level of debt
obligation of any enterprise that is proposed for ownership transfer. A
high proportion of SOEs in developing countries are however loss-
makers, and divestiture in such circumstances is only likely to be
feasible when significantly sweetened by market and tax concessions.

8. **Country risk/perceived political instability:** Some government actions
in the past (for example nationalisation of private businesses) have
left deep scars in the minds of many a potential investor, both foreign
and domestic. For instance, in Ghana, there is still uncertainty among
Ghanaian businessmen as to whether the government had really
changed its attitude towards private enterprise, after all the years of
dirigisme and anti-business behaviour. Also the much-needed foreign capital is not forthcoming because of perceived political instability in most of the countries with a history of coup d'etats and political upheavals. See Dijk (1994), and also Adda (1989).

2.9 SUMMARY

This chapter has been largely devoted to examining some theoretical literature available on the subject matter of this study – Privatisation. However, privatisation could not be better studied without some fair knowledge of the basic ingredient from which it is ‘processed’ – that is, the State-owed enterprises (SOEs). An attempt was made at defining both terms in turn. The term SOE, we found out, does not lend itself to a straightforward definition. However, it does carry some distinguishing characteristics worth noting: First an SOE must be owned by the government; second, must be engaged in the production of goods and services for sale; and finally, sales revenues should bear some relationship to cost. On the other hand, privatisation can be seen as an all-embracing term for several actions, all of which are directed at shifting activity from the public sector to the private sector. These ‘several actions’ have come to be accepted as the methods of privatisation, each of which is directed at some specific economic objective; among which efficiency improvement stands very tall. Efforts were also directed at analysing some arguments raised against privatisation. Again, economic efficiency remains the pivot around which these arguments evolve; making it important for us to devote the next chapter to some further discussion on the subject.
3.1 INTRODUCTION

In the preceding chapter, we examined a vast array of literature on the economic concept of privatisation. The studies so far considered, tended to be more theoretical in approach and were directed at explaining the meaning, nature, and rationale for this all-important policy, which is speedily catching grounds across nations in the world. The discussion gradually devolved down to two sets of arguments, one in favour of (which are basically embodied in the objectives) and the other against (given extensive coverage under section 2.7) privatisation. Notwithstanding the relative importance of all the other factors, the concept of efficiency remains the cardinal point from which both sets of argument diverge. However, the issue of efficiency cannot be contended in isolation. It is tightly hooked to the question of ownership, as privatisation basically involves the transfer of ownership from the state to the private sector. In this chapter, we shall attempt an in depth examination of the concept of efficiency. The vital role of ownership shall be addressed, against the backdrop of fundamental economic theories that largely underpin the ownership-efficiency debate, namely, the agency, property rights and the public choice theories. We continue with a look at the measurement of efficiency and then some empirical evidence of the impact of privatisation on corporate performance. A brief summary of the chapter finally draws the curtain.
3.2 THE MEANING OF EFFICIENCY

The word *efficiency* is part of everyone's vocabulary, but at the same time one of the central concepts of economics. To most, efficiency means producing a desired result with a minimum effort or expense. It is synonymous with the minimization of wasted effort. The economist’s criterion of efficiency is somewhat more precise than the standard dictionary definition, even though it does carry the same idea. Samuelson and Nordhaus (1989) defined it as the use of economic resources that produces the maximum level of satisfaction possible with the given inputs and technology. That is, the absence of waste, using the economy's resources as effectively as possible to satisfy people's needs and desires. Baumol et al (1992) also defined efficiency as the absence of waste, achieved primarily by gains in productivity resulting from specialisation, division of labour and the system of exchange; describing an efficient economy as one that utilises all of its available resources, and produces the maximum amount of output that its technology permits. To the economist however, efficiency may take either of two different forms: a) allocative efficiency, and b) technical efficiency.

**Allocative Efficiency (Pareto Efficiency)**

Allocative efficiency is sometimes referred to as *Pareto efficiency*, (named after Vilfredo Pareto, who developed the concept). It is generally what economists have in mind when they refer to *economic efficiency* or simply, *efficiency*. We may take a look at a few definitions as follows:

Allocative efficiency occurs when there is no other reorganisation of production or consumption that will increase the satisfaction of one person
without reducing the satisfaction of another person. More informally, efficiency means that no one can be made better off without making someone else worse off. (Samuelson & Nordhaus, 1989, pp. 747)

Allocative efficiency, i.e. have resources been allocated according to the preferences and budget constraints of the consumers of final products? In a pragmatic sense allocative efficiency refers to the following questions: does the public sector produce the optimal level and mix of services (public expenditures) which the electorates demand? Is the voter sovereign in the ‘political market place’? Whose preferences count? (Brown & Jackson, 1986, pp. 171)

Allocative efficiency. This is an aggregative, economy-wide concept that requires inputs and outputs to be priced at their respective marginal costs and allocated in accordance with preferences and income constraints of consumers. It is a question about what point on the production possibility frontier is optimal. Allocative inefficiency occurs if the distribution of particular public sector outputs is not in accordance with those personal preferences, for example where a planner or monopolist distorts that allocation. (Bailey, 1995, pp. 106)

We may infer from the descriptions above that, allocative efficiency is generally a normative criterion for evaluating resource use in terms of the effects on the well being of persons and thus virtually leads into the realm of welfare economics. It finds fertile grounds under conditions of perfect competition. The general-equilibrium market system associated with perfect competition, will usually display allocative efficiency. Such a system has all goods prices equal to marginal costs, all factor prices equal to the value of their marginal products and contains no externalities. Under such conditions, when each producer selfishly maximises profits and each consumer selfishly maximises utility, the economy as a whole is efficient in the sense that you cannot make anyone better off without making someone else worse off. (See figures 3.1 and 3.2). The basic condition for allocative efficiency is that the marginal rate of substitution (MRS)\(^{11}\) should equal the marginal rate of substitution (MRS)\(^{11}\) should equal the marginal rate of

\(^{11}\) Refers to the maximum amount of one commodity a consumer is willing to give up in exchange for one more unit of another commodity. It is the slope of the indifference curve.
transformation (MRT)\textsuperscript{12}. Whenever the MRS does not equal the MRT, it is possible to reallocate resources and make someone better off without making anyone else worse off; and allocative efficiency does not exist. (See figure 3.3)


We noted in the previous chapter (coupled with the additional illustration here) however, that, perfect competition is largely an ideal situation that is assumed under the 'invisible hand theory'. In reality however, the prevalence of market failures tend to blur the idyllic picture of perfect competition. The existence of natural monopolies, externalities, public goods etc make it such that the conditions for Pareto efficiency are either vastly eroded or fail to exist altogether. This shortcoming makes it obvious that, allocative efficiency may not be that relevant for studies on privatisation, which tilts more towards the analysis of positive economics. We shall discover later, as this discussion unfolds, that most studies on privatisation tend to focus on technical rather than allocative efficiency. This is particularly so with studies on the comparative performance of firms. The reason is largely due to the difficulties involved in operationalizing the marginal cost-pricing rule and also in obtaining data on marginal costs. See Lipsey & Lancaster (1956); Baumol & Bradford). Secondly, privatisation involves changes in the ownership of the firm; hence ownership is of more relevance in assessing the impact of any such change; rather than competition which takes the emphasis in\textsuperscript{12} In perfect competition, the MRT between any pair of products is equal the ratio of their market prices. Generally, it is the rate at which the economy can transform one good into
determining allocative efficiency. See Parker & Hartley (1991). The importance of allocative efficiency cannot however be totally ignored, especially in assessing the welfare, social or equity objectives of some state enterprises as already noted in the previous chapter.

Figure 3.1: Allocative Efficiency (The Utility Possibility Frontier-UPF)

Figure 3.1: An economy is operating efficiently when no person’s satisfaction can be improved without lowering someone else’s satisfaction. Efficient points are on the utility Possibility frontier (UPF). Moving from outcome A to outcome C can improve Mr X's position only by hurting Mr.Y; point A is therefore efficient. Point B is inside the UPF. It is thereby inefficient because Mr.Y or Mr X or both can be made better off without hurting anyone.

another good. It is the slope of the production possibilities frontier.
Figure 3.2 illustrates the efficiency of perfect competition. The hypothetical population is divided into two groups, Y and X and the satisfaction of either group is shown on the two axes. Points A and B represent alternative competitive equilibria. As perfectly competitive economies, both operate efficiently. On the other hand, point C shows an economy faced with externalities and/or some natural monopolies. Economy C operates well inside its frontier, with groups X and Y both losing consumption relative to efficiently operating economy B. This explains the point that all perfectly competitive economies operate efficiently and are somewhere on their utility possibility frontiers.
Figure 3.2: For allocative efficiency to prevail, the MRS must equal MRT. The diagram shows a typical consumer in equilibrium at point Eo on the budget line cd. Although different consumers have different incomes, and hence have budget lines that are different distances from the origin, all face the same prices and so all have budget lines with the same slope, and hence the same MRS. Because each consumer faces the same prices as do producers, the slope of the budget line is equal to the MRT. Because the consumer reaches a tangency with the budget line, the MRS at Eo must be equal to the MRT. If producers face a relative price different from that faced by consumers, the MRT will have a slope different from the budget line. An example is shown in the figure by the line MRT', whose slope does not equal that of the budget line cd. Consumers remain in equilibrium at Eo. On the
other hand, by altering the allocation of resources, holding the consumption of all other consumers constant, production (and for that matter this consumer's consumption) could, by assumption, be moved along the line MRT'. In this case, higher indifference curves could be attained by moving to the right along MRT'. Hence the equilibrium at Eo is not efficient when MRT does not equal MRS.

Technical Efficiency (Productive efficiency)

Technical efficiency draws attention to the firm's performance as induced by its internal incentive and accountability structure. Technical inefficiency may thus occur if the firm fails to minimise cost, and may be attributed to incorrect internal signals that induce non-maximizing behaviour. See Hutchinson (1991). Technical efficiency (also referred to as productive efficiency) has also come under the name X-Efficiency in most economic literature. Some important definitions are considered here.

**X-efficiency.** This is an organisation specific concept denoting general managerial and technological efficiency at the level of the firm, bureau or organisation. It is a corollary of the profit maximisation assumption, which requires firms to use inputs, solve their organisational problems and produce output at least cost. However, X-inefficiency may occur if organisations are insulated from competition by natural monopolies or statutory monopolies. Bureaucratic empire building is a cause of inefficiency. (Bailey, 1985, p.106)

X-efficiency, this refers to the supply side. Irrespective of whether or not the public sector does produce the optimal level and mix of public services are these services produced at minimum cost? Is there over-manning? Are the best practices and most efficient technologies used? To the extent that they are not, there is said to exist X-inefficiency in the system. In other words, the public sector is not operating on its efficiency frontier whereas in the case of allocative efficiency it is operating at the wrong point on its efficiency frontier. (Brown & Jackson, 1986, pp. 171)

Productive efficiency is concerned with the lowest cost method of producing output and can itself be divided into two parts – static and dynamic efficiency gains. Static efficiency relates to producing existing products more efficiently while using existing production processes. By contrast, dynamic efficiency is
concerned with raising performance by improving products and processes over time.  
(Martin & Parker, 1997, p.47)

Perhaps we may agree with Page (1980), that technical efficiency is a somewhat elusive concept. The seeming ambiguity may be due in part to the wide range of definitions available. We may note however that the terms technical, production, managerial and X-efficiency have been used interchangeably in most literature. In his 1977 contribution, Liebenstein argued that what is called technical efficiency is in fact a manifestation of X-efficiency. Pack (1974) also attempted a distinction between technical efficiency, which arises from firms’ access to technology and X-efficiency, which he associated with the quality of management. Page (1980) however considered each of these definitions as one component of measured technical efficiency.

The varied definitions notwithstanding, the common importance attached to the role of management in the production process cannot be overlooked. Liebestein (1966) argued that firms might fail to produce on the outer boundary of their production surface because of the preference structure of managers and workers, a situation that may lead to variations in the level of X-efficiency. Shapiro and Muller (1977) also found a significant correlation between technical efficiency and the entrepreneur’s stock of information, arguing that variations in technical efficiency may arise from differences in the stock of knowledge possessed by managers and from differences in the quantity and quality of management effort supplied to the firm.
There is an important relationship between technical (or managerial) efficiency, price efficiency, the choice of technique, and economic performance. Page (1980) for example attempted clarifying this relationship, dwelling largely on concepts developed by Farrell (1957)\(^\text{13}\). Whereas the intricate details of this relationship fall outside the scope of this study, we shall however employ the concept here to illustrate our discussion on technical efficiency. (Figure 3.4). We shall revisit the issue (though briefly) in our subsequent section on 'performance measurement', also in this chapter.

In figure 3.4, we assume that all firms in the industry employ two factors of production in a well-behaved linear homogenous production function and so production decisions may be represented in input space by a point giving the combination of primary factors required to generate one unit of output. The input combinations of each firm give rise to a scatter of observations in the input plane. A unit isoquant is drawn to join the points that represent minimum input combinations, such that, no observation lies between the envelope and the origin. This defines the frontier, which represents the minimum quantities of inputs required per unit of output given existing technology. From the diagram, we may observe that, Firms A, B, and C all lie on the isoquant, FF'. At their respective levels of output they use no more of the two inputs than required and are said to be technically efficient. On the other hand, firm D exhibits an input combination to the right of the frontier and is thus said to be technically inefficient.

Figure 3.4: Technical Efficiency (The Farrell diagram)

By far the most cited work in most literature on technical efficiency is Leibenstein's General X-efficiency theory\(^{14}\). A brief examination of his study thus provides an appropriate conclusion to our section on the 'meaning of efficiency'.

Leibenstein's General X-Efficiency Theory

Leibenstein describes the idea behind his theory thus:

The X-efficiency idea, in a narrow sense, is an extremely simple one. Suppose that certain inputs have been allocated to a firm. These inputs can be used in various degrees of effectiveness within the firm. The more effectively they are used the greater the output. When an input is not used effectively, the difference between the actual output and the maximum output attributable to that input is a measure of the degree of X-inefficiency. In this context X-efficiency is to be contrasted with allocative efficiency, the latter being the form of efficiency commonly considered in neoclassical economics. The basic notion is that we must distinguish between the allocation of inputs to legal decision-making units (such as firms and households) and the effective use of these inputs within such decision-making units. (Leibenstein, 1978, pp.17-18)

The theory asserts further that the effective use of inputs depends simultaneously on both the decisions that are made on how to use inputs and the actual performance based on these decisions. This implies that the X-inefficiency concept will capture both the detailed decision-making process (which may indicate how inputs are to be used), and the measure of actual performance, within the firm. The X-inefficiency concept is further considered in terms of the inputs needed to produce a predetermined output by the firm. Figure 3.4 below illustrates this point. The theory further extends the definition of inputs to include the knowledge of opportunities open to the firm and/or the information on how to obtain such knowledge. Also considered, as

part of the X-inefficiency phenomenon, is the difference between the value of maximising the opportunities open to the firm and those actually utilized. The differences between the basic components of the X-efficiency and the neoclassical theories, as presented by Leibenstein, are captured here as Table 3.1 below.

We have already noted in our discussion that, X-efficiency (rather than Allocative efficiency) is of much more importance to the concept of privatisation; the reasons we have also explained in our discussion on allocative efficiency. Suffice it, therefore, to say here that subsequent references to efficiency in this study relate to X-efficiency (technical efficiency), unless otherwise stated. Also technical efficiency and economic performance may be used interchangeably.
Figure 3.5: Leibenstein’s General X-Efficiency Theory

The value of the minimum inputs needed is designated by $V_o$. The actual inputs needed are designated by $V_a$. The ratio of the difference between the two over the actual expenditure ($V_a - V_o$) is also a measure of X-inefficiency.
Table 3.1: A Comparison of the Neoclassical and the X-Efficiency theories

<table>
<thead>
<tr>
<th>COMPONENTS</th>
<th>X-EFFICIENCY THEORY</th>
<th>NEOCLASSICAL THEORY</th>
</tr>
</thead>
<tbody>
<tr>
<td>Units</td>
<td>Individuals</td>
<td>Households and firms</td>
</tr>
<tr>
<td>Psychology</td>
<td>Selective rationality</td>
<td>Maximization or minimization</td>
</tr>
<tr>
<td>Effort</td>
<td>Discretionary variable</td>
<td>Assumed given</td>
</tr>
<tr>
<td>Inert areas</td>
<td>Important variable</td>
<td>None</td>
</tr>
<tr>
<td>Interpersonal interactions</td>
<td>Some</td>
<td>None</td>
</tr>
<tr>
<td>Agent-principal relationship</td>
<td>Differential interests</td>
<td>Identity of interests</td>
</tr>
<tr>
<td>Cost impactor / impactee relations</td>
<td>Impactors not equal to impactees</td>
<td>Not relevant or impactors identical to impactees</td>
</tr>
</tbody>
</table>

3.3 OWNERSHIP CHANGE AND MICROECONOMIC EFFICIENCY: 
THE ORIGINAL DEBATE

The superiority of private ownership over public ownership (in terms of efficiency and economic performance) has become a generally accepted notion. It is the singular clarion call being trumpeted by the IMF and the World Bank to governments across the globe (particularly those in the less developed countries), to brave every odd and let go of state ownership within their various economies. The idea of private sector supremacy is not new however. It goes as far back to the days of Adam Smith, who wrote:

In every great monarchy in Europe the sale of crown lands would produce a very large sum of money, which, if applied to the payments of the public debts, would deliver from mortgage a much greater revenue than any which those lands have ever afforded to the crown... When the crown lands had become private property they would, in the course of a few years become well improved and well cultivated.
(Adam Smith, 1776, p.824)

Some arguments have since been raised in economic literature to explain the seeming dichotomy (in performance and economic efficiency) between public and private sector firms. Our emphasis in this section however is on the importance of ownership and whether ownership change per se is enough to induce the necessary improvement in performance. We start this section by examining some of the arguments raised in support of the private sector superiority. This is followed by a brief look at the role of competition (vis-à-vis ownership change) in creating the right conditions for efficiency improvement. We draw the curtains on the section by analysing three fundamental theories underpinning the efficiency arguments, namely: the Agency, Property Rights, and the Public choice Theories.
3.3.1 The Efficiency Debate: The Case for Private Ownership

Arguments raised in economic literature in support of the superiority of the private sector in achieving economic efficiency have come under five major headings: 1) The objectives of the firm, 2) Ease of implementing objectives, 3) Employees incentive structure, 4) Nature of the firm's budget constraint, and 5) Role of the capital market. We now take them in turns, juxtaposing the public and the private firms in the light of the arguments that unfold.

1. Objectives of the firm

The objective of the private firm is at all times clear and concise – profit maximization. This is however not the case with the public firm, which is faced at most times with a multiplicity of goals, and a barrage of objectives that are not clearly defined. The private sector manager will avoid inefficiencies that tend to increase cost, since increase in costs lead to lower profits. To the contrary, profitability comes merely as one of the many objectives of the typical SOE who may be additionally charged with other social, welfare and political goals. Efficiency ceases to be a high priority objective for the public sector manager, whose own priorities are often implicit. Consequently, employment objectives, rewarding party loyalists and subsidizing urban residents become the main thrust of efforts within the SOEs and these are vigorously pursued even at the expense of economic performance. See Prager (1992,1997); Martin & Parker (1997).
2. Implementation

This argument is closely linked to that of objectives above and has come under a broader banner of political perspective in some other studies. See Shapiro & Willig (1990); Shleifer & Vishny (1994). The assertion here is that, there are distortions (within the public sector) not only in the objective function that managers seek to maximize, but also in their efforts to implement such objectives. The public sector manager whose objectives are already shrouded in ambiguity is again poorly informed on the priorities of the enterprise and may not even know when the rankings change. Excessive political intervention stifles business acumen and economic expediency, as order from above becomes the rule rather than the exception.

This is in sharp contrast to the private sector where the clear objective of profit maximization strictly dictates the path for its implementation. Political time frames are generally incompatible with the longer time cycles that successful investment needs. For example, an impending election is unlikely to have any noticeable effect on the production, investment or pricing decisions of the typical private firm. The same cannot be said about the SOE, however, particularly in the event of political superiors insisting on retaining redundant workers (because they are potential voters), initiating investment projects in swing regions or neighbourhoods or delaying price increases despite increased input costs. Thus, even where a set of priorities is given, efficiency still suffers as SOE management is prevented from managing. See Vickers & Yarrow (1988); Martin & Parker (1997); Prager (1997)
3. Incentive Structure

The argument on incentives has most often been carried within the framework of the principal-agent theory. Again basic differences have been identified between the public and the private sectors that tend to give the private enterprise a clear lead in efficiency and economic performance. Private sector firms do not only match their public sector counterparts in terms of wages and benefits, but are also able to provide performance or profit related incentive schemes to employees. Furthermore, reward packages may be designed to motivate middle and top management staff, such as promotions and other awards linked to company's share price, like share ownership or options schemes.

These rewards are however largely unavailable to the SOE. In the first place, a profit related incentive scheme might be counterproductive to the public sector firm because profits tend to be just one of its numerous objectives and some firms may not be making any profits at all. Secondly, rewards linked to shares are also not tenable because the SOE is owned by the public as whole and not by individuals. On the other hand, poor financial performance by the private firm might be penalized by the threat of takeover and can lead to the dismissal of employees (from the lowest level of staff to the highest). The SOE does not face this threat however, due to its reduced emphasis on profitability. It is thus more likely to retain inefficient and redundant employees. See Vickers & Yarrow (1988); Martin & Parker (1997); Prager (1997)
4. Budget Constraints

The core point of this argument is that, bankruptcy is not a credible threat under public ownership. In any situation in which the typical SOE engages in unwise investments, it will be in the interest of central government to bail the firm out using the state budget. The reason is basically political in that, the bankruptcy of the SOE would have a high political cost, whose burden would be distributed within a well-defined political group, like unions. On the other hand, the cost of the bailout can be spread over the taxpayers, a less organized, larger group in society, with diversified interests and preferences. See Sheshinski & Lopez-Calva (1999); Kornai (1980, 1986); Shapiro & Willig (1990); Shleifer & Vishny (1994).

To the contrary, the private firm, though may do with some temporary losses, cannot operate with a permanent flow of budgetary red ink, that might eventually lead to virtual collapse, unless supplemented by new capital inflows. As noted by Prager (1997), 'the private firm's 'hard budget constraint' becomes effective well before losses pile up, for anticipated losses serve as the stick that supplements the carrot of dividends and capital gains to private owners. Management will be replaced long before the corporation's capital is fully eroded'.

The SOE, as we have already noted faces a 'soft budget constraint', and so long as government continues to subsidize the firm, poor performance will not necessarily lead to bankruptcy. Again, the effectiveness of management
is not judged by profit alone but by such other criteria as loyalty to ruling government. The end result is poor economic performance and gross inefficiency at various levels within the typical SOE. See also Vickers & Yarrow (1988); Martin & Parker (1997). Sheshinski & Lopez-Calva (1999) illustrated the idea of soft budget constraint with a simple flow chart as shown in figure 3.6 below.

Figure 3.6 considers a decision the public sector manager has to make of whether or not to invest in a new project. The decision to invest is denoted by I. The alternative decision is not to invest (NI). If the decision is not to invest, the central government gets a payoff of zero, and so does the public manager. If the investment takes place, it would be profitable with probability \( \alpha \) and non-profitable with probability \( (1- \alpha) \). Regardless whether the investment turns out to be a profitable one or not, the manager gets a personal benefit from the expansion of the firm's activities (B), following the "empire-building" hypothesis. Positive profits give an extra payoff to the manager (P) and give a positive transfer to the central government via tax revenue. On the other hand, should the project fail, the central government faces a decision between two possible actions: to bail the firm out or let it go bankrupt. In the former case, the central government has a negative payoff (S, the subsidy) though the manager still gets the benefit of managing a larger firm. If there is no bailout the manager loses the job and has a negative payoff (-B, loses prestige), whereas the central government faces a political cost of closing the firm (facing union problems, explaining to public
opinion why the firm failed and so on). The political cost is denoted by $X$. As long as $X > S$ (the political cost incurred by the central government by closing the firm is higher than the cost of giving a subsidy and bail out), the manager will always make the investment, regardless of the probability of failure.

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15 The "empire-building" hypothesis indicates that managers maximise the size of the firm so as to enhance their own prestige.
Figure 3.6: The Soft Budget Constraint

Manager's decision

Invest I

No Investment (NI)

Nature's move

Bad outcome
Probability (1-a)

Central Government's

No bailout

(B, -S)

Bailout

(P+B, T)

Good outcome,
Probability a

No bailout

(-B, -X)

5. Capital Markets

This is another agency related argument and comes under the *managerial perspective*. This perspective views imperfect monitoring as the first cause of low-powered incentives within the public sector. It is argued here that managers of SOEs are poorly monitored because the firms are not traded in the market, as is the case with private firms. See Yarrow (1986); Vickers & Yarrow (1989). Diffuse ownership and non-transferability of public sector shares tend to reduce the incentive for public sector shareholders to monitor management, let alone influence the performance of the enterprises. See Zeckhauser & Horn (1989). Moreover, debt markets cannot play the role of disciplining the managers, because SOE debt is actually public debt and traded under different conditions. The threat of takeover is thus eliminated even as firms continue to perform poorly. See Sheshinski & Lopez-Calva, (1999)

A converse situation however prevails within the private sector. The threat of takeover of firms with traded equity serves as a further booster to efficiency in the private sector. The value of a corporation is reflected in its stock market capitalization. (i.e., the number of shares times the price per share). When a listed firm performs poorly, equity prices fall and this subjects the firm to takeover threats from a new set of owners. See Alchian (1965); Jensen and Meckling (1976); Fama (1980) An active equity market may impact positively on listed firms in three different ways. First, management is persuaded to strive for high profits and strong capital values in order to avoid takeover threats. Second, it makes it possible for non-performing managers
to be replaced, following take over, by new sets of owners. Third, the value of a manager's human capital is likely to depend on the value of the firm as revealed in its share price. Managers have an incentive to seek a high return for shareholders because their association with a successful firm increases their own value in the market for managers. These incentives within the capital market are however absent from SOEs going by their very definition. In fact, there are no shares to be traded and managerial appointments depend on government decisions, which may not be weighted by economic results. See Prager (1997); Zeckhauser & Horn (1989); Fama (1980).

It is important to note however that, in economies where capital markets are not very well developed, takeover may cease to be a realistic threat. This is a most likely situation in the less developed countries (LDCs). Again, privatisation programmes in most LDCs have emphasized divestiture through strategic investor financing and individual purchasers or the introduction of private capital into joint ventures, rather than sale through the stock market. Incentives on the capital market may thus not be available to most privatised firms. See Cook & Kirkpatrick (1988); Ziorklui (2001). Even with the industrialized countries some available studies (particularly that of Grossman & Hart, 1980) have provided evidence that go to weaken the threat of takeovers as well as grossly undermine the monitoring capacity of shareholders and for that matter the strength of the capital market as an efficiency enhancing mechanism\textsuperscript{16}.

3.3.2 Ownership And Competition

We may begin this section with a cautionary note from Vickers & Yarrow (1988) that privatisation (the transfer of ownership) and liberalisation (the opening up of competitive forces) are logically quite distinct concepts. Public ownership does not imply state monopoly, just as private ownership does not necessarily translate into competition. It is a fact however that privatisation and liberalisation are often intertwined in policy debate and public perception, and most privatisation policies have been accompanied by the stimulation of some competitive forces. The importance of ownership has drawn the attention of researchers in the area of microeconomics and to date vast literature exists that addresses the question of why ownership matters. Of particular interest to the study of privatisation are the works of Kay & Thompson (1986); Vickers & Yarrow (1989); Schmidt (1990); Stiglitz (1991); Yarrow (1992); Laffont & Tirole (1993, ch. 17); Willig (1993); Perotti & Guney (1993); Galal et al (1994); Tirole (1994); The World Bank (1995); Schmidt (1996); McLindon (1996); Shleifer & Vishny (1996); Hart, Shleifer & Vishny (1997); Nellis (1997) and Shleifer (1998).

Of prime concern to the current study (and for that matter, the study of privatisation) is the question whether ownership change just by itself is enough to bring the needed improvement in efficiency within the public sector enterprise. At the extreme end, is the view that smacks of the irrelevance of ownership, pushing it to a rather low level in the hierarchy of policy prescriptions. See Stiglitz (1993); Vernon-Wortzel & Wortzel (1989). Two
main issues make up the argument here: 1) that efficiency gains can be achieved through the introduction of competition and the maximization of market contestability through policies of deregulation, and 2) that the elimination of legal barriers to entry is sufficient to provide the level of competition necessary to achieve the desired goals.

These arguments have not however gone without some objections. Two caveats have been provided. First, the existence of a publicly owned firm as the incumbent (in most cases subsidised, and having a preponderant share of the market) may deter other firms from entering that market, even when it becomes legal to do so. It would be difficult to introduce real competition under such conditions. Competition implies not only free entry, but also free exit. It follows therefore that; the continued presence of public firms in the market would make free exit a non-credible commitment to such firms.

Secondly, it is not possible to have competition in most markets because of the existence of natural monopolies. Under such conditions, the introduction of competition by eliminating legal barriers will not be sufficient in securing efficiency gains. It is further contended that ownership changes may be needed compliments for the creation of a market environment through the necessary legal reforms and opening to international trade. See Sheshinski & Lopez-Calva, 1999; Cook & Kirkpatrick, 1988; Vickers & Yarrow, 198817.

Whereas the previous arguments may be seen as dwelling largely on the importance of potential competition, others centre more on the role of competition as an incentive mechanism:

The problems of monitoring and rewarding manager's effort and efficiency arise under both public and private ownership. The asymmetry of information that exists between the managers of the firm and the government ministry or regulatory agency is at the heart of the matter. The competitive process and the results it delivers (especially in the form of comparisons between rivals' performances) can reveal information in a most economical fashion, and it therefore acts as a natural and useful incentive mechanism. Thus the competitive process provides a spur to internal efficiency and the elimination of X-inefficiency, as well as serving as a mechanism conducive to allocative efficiency.

(Vickers & Yarrow, 1988, pp.46-47)

Flowing from the above, the argument continues that, a profit-oriented private firm would be driven to efficient operation only if its costs cannot be passed downward to factor suppliers or upwards to purchasers. This means that efficiency would not be a compelling outcome if privatisation merely converts a public monopoly into a private monopoly. On the other hand, competitive pressures would force an SOE operating in a competitive environment to pay market rates for its inputs and charge no more than the market prices for its products if it is to stay in business (unless the government is willing to subsidise its losses permanently). There is therefore no clear ground to conclude that a private monopoly would be more efficient than a public monopoly, hence the assertion that, privatisation that changes ownership without the necessary changes in market structure is unlikely to achieve the desired results. See Cook & Kirkpatrick, 1988; Prager, 1997; World Bank 1983; Vickers & Yarrow, 1988.

Again, it should be noted that the impact of ownership and competition (in the product market) are quite distinct, and though the effect of competition on
performance is much less controversial in economic theory, the effect of ownership per se is not that clearly determined. It is argued however that, if competition in the product market does not change with privatisation, then the source of any performance improvement will lie in a change in the capital market; that is, directly in the change of ownership. Privatisation (change of ownership), it is asserted here, subjects enterprises to the discipline of the competitive capital market, which many believe imposes a more effective constraint on managerial discretionary behaviour than political control. This, it is claimed, results in higher efficiency even under similar market conditions. See Martin & Parker, 1997; Crain & Zardkoohi, 1980; Pera, 1989, p.189.

It should be possible for us now to see the important link between ownership and market structure (competition), and also the capital market. The relationship, though seemingly complex, is more of interdependence, and their overall impact on economic performance is simplified here in table 3.2 below.
Table 3.2: Ownership And Market Structure: A Taxonomy

<table>
<thead>
<tr>
<th>OWNERSHIP</th>
<th>MARKETS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Monopoly</td>
</tr>
<tr>
<td>Public</td>
<td>A</td>
</tr>
<tr>
<td>Private</td>
<td>C</td>
</tr>
</tbody>
</table>


The framework presented in table 3.2 may be explained as follows:

- **A** represents a public sector monopoly with limited product market competition. Mainly subsidised by government without much incentive for management to achieve high efficiency. It is characterised by low efficiency.

- **D** represents a private firm in a competitive product market. It is expected to raise funds mainly from the private capital market; hence both the product market (competition) and the capital market (tradable shares) constraints apply. Productivity is expected to be very high as managers have high incentives to operate their firms efficiently.

\(^{18}\) See also Martin & Parker (1997) *The Impact of privatisation: Ownership and corporate Performance in the UK*, pp. 9.
• B and C are intermediary positions, representing mid-way conditions in which either the product market or capital market constraints on behaviour are limited.

• B is superior to A, reflecting the role of competition.

• C is superior to A reflecting the policing role of private capital markets in a non-competitive environment.

• Generally, it would be expected that maximum efficiency gains would arise when privatisation is combined with the introduction of competition in the product market; that is where there is a move from point A to D. Smaller gains may however be expected with a move from A to C (privatising a monopolist) or from B to D (privatising a public firm in a competitive market. Similar marginal gains may be expected moving from A to B (exposing a state owned monopoly to competition or from C to D (exposing a private monopoly to competition.

3.3.3 Fundamental Theories underlying The Ownership-Efficiency Debate

Underlying the debate on ownership and efficiency, and silently spanning our discussion so far, are three economic, or rather, organisational theories that have largely taken the centre stage in studies on ownership and theories of the firm; and have been especially important in shaping attitudes towards public and private ownership. These are the agency, property rights, and public choice theories. Although separately developed and coming from quite different analytical traditions, these theories produce highly complimentary
conclusions, the property rights and the public choice theories being often analysed within the framework of the principal-agent relationship.

The Agency Theory

We may open the discussion here with two important descriptions of the principal-agent relationship as follows:

A general description of the agency problem runs as follows. There exists a principal and an agent — the owner and the manager of a firm, for example — who do not share the same objectives. The principal wants to induce the agent to act in his (the principal's) interests, but he does not have full information about the circumstances and behaviour of the agent, and so he has a monitoring problem. This prevents the principal from successfully telling the agent what to do, for he cannot fully observe what is happening. In the event he would usually want the agent's behaviour to depend on circumstances that perhaps only the agent can observe. Principal-agent theory is concerned precisely with this problem of information and incentives. It addresses the central question: what is the optimal incentive scheme for the principal to lay down for the agent?

(Vickers & Yarrow, 1988, pp.9)

Agency theory refers to a contract in which one party is designated as principal and another, the agent. The agent contracts to carry out certain activities for the principal, and the principal contracts to reward the agent accordingly. Three assumptions are at the core of the agency theory. The first is the one common to most economists: individuals maximise their own interest. The second is more specific to agency theory: social life is a series of contracts, or exchanges, governed by competitive self-interest. The third is applied to internal organisational analysis: monitoring contracts is costly and somewhat ineffective, especially in organisations, thus encouraging self-interest behaviour, shirking, and especially opportunism with guile, or put it more simply — cheating. Contracts will be violated because of self-interest, and can be violated because of cost and ineffectiveness of surveillance.

(Parrow, 1986, p12)

Both the private and the public sectors do exhibit elements of the principal-agent relationship at various levels. In the private sector a simple relationship exists between shareholders (principals) and directors (agents). The shareholders own the firm and appoint the directors to manage it on their behalf. The relationship is however more complex in the public sector, where the ultimate owners of state assets, the principals, happen to be the
public (tax payer). The complexity arises from the layers of agencies that exist between the managers of public firms (boards of SOEs) and the public. These layers of agencies may include elected representatives (members of parliament), government ministers (departmental heads etc), and all the way to boards of SOEs etc. (Aharoni, 1982; Martin & Parker).

From the descriptions above, four main issues emerge from the principal-agent relationship that are of immense importance to the concept of privatisation. These are, asymmetric information, clarity of objectives, monitoring or control, and determination of incentives. The argument is basically that; the principal is handicapped by lack of certain information, which only the agent knows precisely. There may be particular parameters affecting efficiency, which only the agent (manager) knows, the principal’s knowledge being restricted to the knowledge of the distribution of the parameters. Efforts of the manager may not be observable and therefore impossible to monitor. Since the principal cannot directly observe the activities of the manager, he cannot directly influence his behaviour. The management has its own objectives; hence it may choose an effort level, which may not be efficient. This situation is mostly taken into account by the principal in defining the incentive package of the manager. See Vickers & Yarrow (1988); Bos & Peters (1991).

The implication of this relationship to privatisation is not far fetched. With regard to information, private owners are perceived to be clever investors who are quite well informed about economic reality. On the other hand, the
existence of layers of agents in the public sector tends to provide scope for 'noise' that distort the information flow between the principals and resource managers. Privatisation is thus viewed as changing the nature of the principal-agent relationship to reduce the 'noise', with the end result that, management now faces a better informed principal than before. See Smith, 1990, p. 55; Bos & Peters, 1991. Also, the objective of private owners – profit maximisation – is clear and well known to the manager. The public sector manager is however confronted with a multiplicity of goals and is uncertain about what weights to attach to each of these goals.

Furthermore, diffuse ownership in the public sector reduces the motivation for shareholders to monitor management. For any individual (tax payer) the costs of information gathering and lobbying are likely to far exceed the benefits that would accrue directly from success in changing policy. It is obvious that, transferability of ownership through a competitive capital market in the private sector makes monitoring by residual claimants more effective than monitoring through the political process in the public sector. Invariably, it is expected that privatisation will foster better monitoring and further facilitate the introduction of more effective incentive (reward) systems that bind agents to the principals' goals. See Rees, (1985). The overall effect of this is increased efficiency. For more detailed discussion on the principal-agent relationship, see Rees (1985), Bos & Peters (1991), Vickers & Yarrow (1988), Jensen & Meckling (1976). A summary of the principal-agent relationship, as presented by Bos & Peters (1991) is captured here as Table 3.3 below.
Table 3.3: Summary of the Principal-agent Relationship

<table>
<thead>
<tr>
<th>CHARACTERISTIC</th>
<th>PRIVATE FIRM</th>
<th>PUBLIC FIRM</th>
</tr>
</thead>
<tbody>
<tr>
<td>Principal</td>
<td>Individuals</td>
<td>Government</td>
</tr>
<tr>
<td>Agent</td>
<td>Manager</td>
<td>Manager</td>
</tr>
<tr>
<td>Objectives of principal</td>
<td>Profit maximisation</td>
<td>1. High consumer welfare</td>
</tr>
<tr>
<td></td>
<td></td>
<td>2. Not too high profit</td>
</tr>
<tr>
<td>Informational status of principal</td>
<td>Very well informed</td>
<td>Less well informed</td>
</tr>
<tr>
<td>Managerial efforts</td>
<td>Optimal</td>
<td>Less than optimal</td>
</tr>
<tr>
<td>Rewards to the manager</td>
<td>Rewarded efficiently</td>
<td>Rewarded lower or higher than efficient</td>
</tr>
<tr>
<td>Control</td>
<td>Efficient</td>
<td>Lower than efficient</td>
</tr>
<tr>
<td>Price setting</td>
<td>Marginal-cost pricing is chosen to maximise profits</td>
<td>Marginal-cost pricing is chosen only if consumer and producer surplus is maximised.</td>
</tr>
</tbody>
</table>

The Property Rights Theory

This is another important economic theory of fundamental importance to the study of ownership, the firm, and the use of resources in any economic society. Demsetz (1988) gave a very apt description of property rights thus:

Property rights are an instrument of society and derive their importance from the fact that they help a man form those expectations that he can reasonably hold in his dealings with others. These expectations find expression in the laws, customs, and mores of society. An owner of property rights possesses the consent of fellow men to allow him to act in particular ways. An owner expects the community to prevent others from interfering with his actions, provided that these actions are not prohibited in the specifications of his rights.

It is important to note that property rights convey the right to benefit or harm oneself or others. Harming a competitor by producing superior products may be permitted, while shooting him may not. A man may be permitted to benefit himself by shooting an intruder but be prohibited from selling below a price floor. It is clear then, that property rights specify how persons may be benefited and harmed, and, who must pay whom to modify the actions taken by persons.

(Demsetz, 1988, p. 104-105)

Lindblom (1977) also defines property rights as follows:

Property is a set of rights to control assets: to refuse use of them to others, to hold them intact, or to use them up. Property rights are consequently grants of authority made to persons and organisations, both public and private and acknowledged by other persons and organisations.

(Lindblom, 1977, p. 26)

Property rights may take three different ownership forms: private, communal, and state. Two important elements set out the differences between private property rights and the other two: 1) the right to authorise use, and 2) the ability to sell that right. Communal ownership means a right that can be exercised by all members of the community and usually takes the form of some common property. In this case a group of individuals is said to own the property and thus has an unrestricted right to all the benefits of the asset.

However, because the benefits of the property are made equally available to all members of the group, no single individual is able to sell his right to the benefits of the property to another member of the group. See Alchian & Allen,
1983, p.91; Brown & Jackson, 1986, p.25-26. State ownership implies that the state may exclude anyone from the use of a right as long as the state follows accepted political procedures for determining who may not use state-owned property. Subsequently, private ownership implies that the community recognises the right of the individual to exclude others from exercising his/her private rights. (Demsetz, 1967).

Bringing our focus down to state owned and privately owned enterprises, Demsetz (1967) noted that what shareholders actually own are their shares and not the enterprises, and we have already traced the ‘diffuse’ ownership of state owned enterprises to the taxpayer public. The property rights literature lays emphasis on the attenuation of these rights where public ownership exists and in turn explores the attenuation of property rights for efficiency. Again, private property rights distinguishes itself by the two characteristics noted above; that is, right to authorise use, and the ability to sell these rights. These characteristics become very important in the efficient allocation of resources through the price system, as the average consumer will not pay much for a commodity whose owner is unknown. The role of the price mechanism is equally weakened when property rights are weak. As noted by Alchian & Allen (1983), prices are guides to how goods are allocated only if people have incentives to make offers and respond to them, as expressed by prices. It follows that where such private property rights in goods and services are weak or ill-defined (especially in terms of exchangeability) prices will have little influence. In this light, it is further argued that private ownership rights in SOEs are generally weak because
they are owned by the state and the implied public ownership of shares is
diffuse and ambiguous. At the same time rights to profits (the residual) are
unclear and equally undefined.

As already stated in the introduction to this section, the standard property
rights approach to public and private ownership acknowledges the
prevalence of agency problems in all forms of ownership, but then because
ownership is transferable through a competitive capital market in the private
sector, a better use of resources results. Monitoring by residual claimants,
for example, is expected to be more efficient than monitoring through the
political process. Alchian & Demsetz (1972) further argued that the firm is a
team of factor suppliers with contracts established and monitored by the
management, who as part of its role, is expected to check free riding and
slacking in the team. However, there are costs in terms of time and effort in
designing an optimal monitoring-reward system, and to achieve this goal,
management will need some form of incentive. In the property rights
literature this incentive is profit (the residual). We are thus led to the
expectation that private sector firms in which rights to profits are clearly
defined would perform more efficiently than those in the public sector where
rights, we have already noted, are diffused and uncertain. It will be clearly
superfluous to state again the implications for, and the role of privatisation in
changing property rights ownership from state to private. See also Jensen &
Meckling, 1976; Alchian, 1965, 1977; Furubotn & Pejovich, 1972, 1974; De
The Public Choice Theory

This is the third of the three fundamental theories underlying the debate on ownership and efficiency. In contrast to the agency and property rights theories, the public choice theory is concerned more directly with actual behaviour in the public sector. It addresses the issues of how the government plays a role analogous to the market and derives its rationale from the important interaction that exists between political and economic behaviours. Samuelson & Nordhaus (1989) defined the public choice theory as:

Branch of economics and political science dealing with the way governments make economic choices: the what, how, and for whom of the public sector. The theory differs from the theory of markets in emphasizing the role of vote maximizing played by politicians, which contrasts to profit maximizing by firms.
(Samuelson & Nordhaus, 1989, p.980)

Mueller’s (1976) definition is also worth noting:

Public choice can be defined as the economic study of non-market decision-making, or, simply the application of economics to political science. The basic behavioural postulate of public choice, as for economics, is that man is egoistic, rational, utility maximiser.
(Mueller, 1976, p.395)

Van Widen (1988) also emphasized egoistic rationality as the fundamental behavioural hypothesis of the public choice theory, leading to the fundamental assumption that, individuals will: a) strive after their own interests, b) behave in a rational way and c) try to maximise utility. Within the framework, the theory encompasses the behaviour of the different agents that are involved in the process of political decision-making. These agents include voters, pressure groups, interest groups (such as trade unions), political parties, politicians, bureaucrats, etc. who may be considered as representatives of both the public and the private sector. The public choice
theory thus recognises the important interaction between the public and private sectors of the economy.

At the centre of the public choice literature is the argument that politicians and state bureaucrats pursue their own utility rather than the public interest. Policies are designed to maximise votes and to further secure the careers of the politicians. The state sector is expanded to satisfy voters, whilst departmental budgets are expanded so that bureaucrats benefit from better jobs and higher salaries. See Tullock, 1965; Downs, 1967; Niskanen, 1971, 1987; Buchanan, 1972, 1978; Blankart, 1983; Mitchell, 1988; Mueller, 1976, 1989; Aranson, 1990. Furthermore, the ability of the public to monitor state sector spending is hindered because the public lacks the necessary information to enable them do so. For the average individual, the costs of gathering information and lobbying (the political transaction costs) may far exceed the benefits that would accrue directly from success in changing policy. The bureaucrats tend to have more information than the taxpayers about the consequences of budgetary changes and so are able to direct policy formation towards their own interests rather than the needs of the economy. See Oslon, 1965; Kristensen, 1980; Breton & Wintrobe, 1982

On the other hand, interest groups such as trade unions and other workers' representatives in the public sector are able to lobby for higher wages and increased staffing levels, whilst contractors and major suppliers make outrageous profits. A fertile ground is thus provided for rent seeking activity in the public sector. It is expected that this condition would be especially true in
countries where state owned enterprises raise little or no capital on the open market and so may not be subject to the disciplining hands of the private capital market; a most likely situation in the less developed countries where the capital market itself is not well developed. See Tullock (1976), and also Bhagwati (1982).

Taken together, the three theories suggest that public and private firms will exhibit major differences in behaviour and hence performance because of differences in: a) management’s objective function, and b) constraints. This in effect reduces the fundamental differences between public and private enterprise to a matter of incentives in the face of incomplete information, which (we have seen from the foregoing discussion) leads to the noted differences in behaviour and performance. Incompleteness of contracts, it is argued, thus becomes the starting point of the theory of ownership. See Hart & Holmstrom, 1987; Holmstrom & Tirole, 1989; Shapiro & Willig, 1990, p.55.

3.4 MEASURING EFFICIENCY OR ECONOMIC PERFORMANCE

The discussion in the preceding sections has largely projected the notion that privatisation brings about improved performance and increased efficiency. The property rights and the public choice theories lend further support to this assertion, leaving in our minds a grotesque picture of a grossly inferior and poorly performing public sector begging immediate transformation into a superior and an all-efficient private sector. As may have been noted through the discussion so far, these arguments and theories do have their own shortcomings as well, and thus do not provide sufficient grounds for us to
draw very concrete conclusions. It is important that some further evidence on the relative performance of public and private enterprises is collated and empirically tested, before any meaningful conclusion is drawn on the impact of privatisation. Privatisation literature is not without such empirical work however.

We begin this section by looking at the basic methods or measures employed in determining organisational performance before settling finally on the empirical evidence of the impact of privatisation.

Three common measures have been identified in privatisation literature for measuring organisational performance (or efficiency). These are a) Profitability (revenue performance), b) Productivity and c) Cost of Production (the production frontier approach). See Martin & Parker, 1997; Millward et al, 1983, p.225; Vickers & Yarrow, 1988, p.39.

Productivity

The productivity measure is basically concerned with the volume of inputs necessary to produce a given volume of output. It is usually represented as a growth rate or index and may take either of two forms – partial factor productivity or total factor productivity.

Partial factor productivity relates to only one of the factor inputs – labour, hence is alternatively called labour productivity. Its simplest representation is output per employee or employee-hour. The underlying assumption here is that the other factors of production, namely capital stock and technology,
either do not change at all, or where they do, would not change in such a
way, as would have a noticeable effect on the volume of output within the
relevant time frame. The growth in labour productivity is calculated as: $\frac{(Q_t / N_t) - (Q_{t-1} / N_{t-1})}{(Q_{t-1} / N_{t-1})}$ where Q is the level of output, N is
employment expressed in total hours worked and t represents the time
periods compared. Labour productivity (LP) is easy to calculate, but since it
does not allow changes in inputs other than labour, it can provide a
misleading picture of an organisation's productivity growth. For example, an
organisation could reduce its labour force substantially while producing the
same level of output using more of other inputs like improved plant and
equipment. It is clearly unlikely that other factor inputs would remain
unchanged in the longer term.

Total Factor productivity (TFP) on the other hand relates output changes to
changes in all factor inputs. TFP growth may also be calculated as:
$\frac{(Q_t / X_t) - (Q_{t-1} / X_{t-1})}{(Q_{t-1} / X_{t-1})}$, where X is a vector of factor inputs. TFP
is obviously a more satisfactory measure than LP. It however has its own
problems with regard to measuring changes in factor inputs, especially the
capital stock. For example, for firms producing several products and/or
using several inputs, the aim of obtaining a volume measure is complicated
by the necessity of aggregating outputs and inputs with weighing systems,
which usually involve the use of prices. Under such conditions TFP growth
may be calculated as $(\text{weighted index of outputs})/(\text{total expenditure on inputs}
/\text{weighted index of input prices})$. In situations where physical output data is
unavailable, productivity may be estimated by using the value of output
deflated into real terms by using an appropriate price deflator. An appropriate composite price deflator may be used for multi-product firms. See Muellbauer (1986); Millward et al (1983); Parker & Hartley (1991); Martin & Parker (1997).

**Costs Of Production**

This is also referred to as the production frontier approach. The productivity approach discussed above essentially tends to measure the degree to which different firms would use different volumes of resources if they produced the same set of outputs. That approach basically reflects the varying facility with which the enterprises combine and use inputs to produce outputs and are thus independent of factor prices. The production frontier approach however tends to reflect the differing effect of input prices. See Millward et al (1983). It is modelled on the cost functions of the firm, which in turn are dependent on the production functions. Cost functions define the minimum cost of producing a specified level of output, given input prices and existing technology, whilst the production function defines the maximum output possible for some specified level of output. This approach relies largely on the concept of static productive efficiency, which is further divided into two parts – *price efficiency* and *technical efficiency*. As noted earlier in our definition of technical efficiency, literature here tends to dwell largely on the concepts of technical and price efficiency developed by Farrell (1957). Overall inefficiency is further divided into two parts: a) *Price inefficiency*, where costs rise above their feasible minimum because inputs are being employed in the wrong proportions given their marginal productivity and
prices, and b) technical inefficiency, where too little output is being produced from a given set of outputs.

It is expected that the efficient mix for any given output is that mix which minimises the cost of producing that level of output. It may also be the combination of inputs that for a fixed money outlay maximises the level of production. Figure 3.7 below illustrates how efficiency may be measured using the cost of production approach. The basic assumptions made here are that: a) the efficient production function is known, b) the production function exhibits constant returns to scale, and c) the firm employs only two factor inputs. Isoquant and Isocost curves have been drawn with two factor inputs x and y. The shape of the isoquants is an indication of the marginal rate of substitution (MRS) between the two inputs. The slope of the isocost lines C₁, C₂, and C₃ is equal to the ratio of the two input prices, Pₓ, Pᵧ, with each isocost line further from the origin representing a larger money outlay. At point C for example, the efficient mix of inputs given the expenditure represented by isocost line C₁ occurs. It is the point at which the highest output can be achieved with the given expenditure. Isoquants by nature are drawn such that each isoquant further from the origin represents a higher level of output. However in presenting technical efficiency here, we assume that each isoquant further from the origin represents the same output but with differences in the efficiency with which inputs are transformed into outputs. It follows therefore that, isoquants Iₐ and Iₖ are associated with the same level of output but the isoquant Iₖ is less efficient. More inputs are needed to produce the same output than Iₐ.
At point A, the firm whose efficiency is being measured is neither technically efficient nor price efficient. Technical inefficiency may be represented by the ratio 

1- (0B/0A). This is the proportion by which the cost of production could be reduced while holding the input ratio constant. Price inefficiency may also be represented by the ratio 1- (0D/0B). This also represents the proportional increase in costs due to the firm's inability to employ the most efficient input mix given marginal products and factor prices. Overall efficiency is given by the product of both price and technical efficiency and is represented here by the ratio 0D/0A. The ratio 1- (0D/0A) indicates overall inefficiency and represents the extent to which costs exceed their feasible minimum.
Profitability

Financial performance (usually expressed as rate of return on capital employed or some derivation, such as earnings per share) has widely been used by the larger divide of society (laymen, shareholders, employees, media, politicians, etc) as a pointer to the economic viability of an enterprise and as a prime indicator of efficiency. Policy makers have also used financial performance of most SOEs as a measure of efficiency and have been quick
to brand loss making SOEs as inefficient without regard to other objectives that these firms might be effectively tackling.

Economists also tend to think of profitability as the measure of performance that best captures both the creativity (the revenue side) and the discipline (the cost side) required for survival in a market economy, at least in the long run. Revenue performance, it is further argued, has some relation to entrepreneurial success and best reflects the advantages of private ownership. See Frydmam et al (1997). Again, accounting rates of return have been employed extensively (notwithstanding some limitations associated with them) in previous studies as measures of economic performance, and evidence suggests that they are significantly correlated with economic rates of return. See also Vining & Boardman (1992, p.220)\textsuperscript{19}.

The foregoing notwithstanding, profitability may not be considered an ideal performance measure in the short run. In the short run, profits may be extremely volatile and subject to a number of accounting decisions, especially with respect to costs, that bear little relation to long-term performance. On the other hand, firms might pursue other objectives such as market share, perhaps with a view to increasing profits in the longer term. Profitability also tends to vary widely across firms because of: a) differences in the degree of importance attached to the profit objective, b) differences in productivity, c) differences in input price efficiency (choosing the input

combinations that minimise costs), and d) differences in the volume and range of products produced and prices charged. As a consequence of these differences, comparisons based solely on profitability (particularly between private and public firms) may have to be proceeded with caution. For example, a public enterprise could exhibit high productivity and be cost efficient, but may be compelled to set low prices, hence low profits, in order to meet some other (social, political or equity) objectives. See Frydman et al (1997); Millward et al (1983); Martin & Parker (1997); Wood (1975).

Furthermore, calculations of profitability involve some complications in that firms tend to differ in their accounting and other financial policies and thus weakening the correlation between accounting and economic rates of return. See Hutchinson (1991); Fisher & McGowan (1983); Long & Ravenscraft, (1984); Davis & Kay (1990). There are for example wide differences (both within and across countries) in depreciation policies, stock valuation methods, asset valuations or wages and salaries practices. Firms may be equally efficient in generating wealth but differ only in the way they distribute that wealth between employees and shareholders (owners). This calls for caution to be exercised when utilizing profitability measures as efficiency indicators when comparing public and private firms.

3.5 EMPIRICAL EVIDENCE ON THE IMPACT OF PRIVATISATION ON CORPORATE PERFORMANCE

Privatisation literature abounds with studies largely aimed at evaluating the impact of privatisation (ownership for that matter) on performance. These studies may be grouped into two main lines of approach namely: a) the historical approach, and b) the synchronic approach.

*The Historical Approach*

This approach comprises those studies that compare pre-privatisation and post-privatisation performance of selected privatised firms. Though intuitively attractive, the historical approach may have problems with having to sort out a potential variety of causal factors. It is believed that pre verses post privatisation comparisons are more meaningful if they involve privatisation programmes in which significant numbers of SOEs are transferred to the private sector. The case however is that most of these programmes come as parts of broader changes in economic policies.

Privatisation has typically been just one policy among a set of structural reform policy measures. These measures include trade liberalisation, deregulation, financial sector restructuring, and opening to foreign direct investment. Such changes as tighter financial discipline and reduced government intervention come along with privatisation, with the effect that, it is difficult to separate the effects of ownership change from the overall impact of economic reforms. This is particularly a problem with most developing countries where privatisation is being pursued as part of wider structural or economic reform programmes. In addition, traditional privatisations
frequently involve significant injections of funds into the firms to be privatised and are usually preceded by extensive preparations during which management and organisational structures are extensively improved. It is further argued that the impact of these preparations may well account for some or all post-privatisation improvements and tend to cloud the impact of ownership change on corporate performance. See Cook & Kirkpatrick, 1988, p.26; Friedman et al, 1997; Sheshinski & Lopez-Calva, 1999.

By far the most important and most cited among the studies that fall under the historical approach is Megginson et al. (1994), who compared the pre- and post- privatisation performance of 61 firms in 18 countries and found that privatisation increases profitability, output per employee, investment, and employment as well as leading to lower leverage and higher dividend payouts. A range of mainly financial indicators was used, including profitability, sales levels, operating efficiency, capital investment, leverage (gearing) ratios and dividend payout figures. The main shortcomings of this study are that: a) it did not control for changes in the economic environment or for most forms of pre-privatisation restructuring (See Frydman et al. 1997), and b) the study looked only at very short periods around the time of public share offerings, plus or minus three years. This is considered too short a time to capture the full effects of ownership change, especially any dynamic gains. (See Martin & Parker, 1997). However, subsequent studies by Claessens & Djankov (1998), D'Souza & Megginson (1998), and Boubakri & Cosset (1998), largely mitigated the effects of these shortcomings by setting controls for market structure, regulation, and the extent of privatisation
(partial vs. full privatisation), whilst still arriving at very similar results of private sector superiority. Other important studies in this category include, Galal et al. (1992, 1994); Caves (1990); De Alessi (1989); Sampson (1995); World Bank (1995); La Porta & Lopez-De-Silanes (1998); Frydman et al. (1994, 1997, 1998);

The Synchronic Approach

This approach to evaluating the relation between ownership and performance focuses on the performance of state and private firms operating under reasonably identical conditions: at the same time, in the same markets, and within the same environment. The synchronic approach also has its own difficulties. There is the possibility of a selection bias and this would have to be avoided if the full effect of ownership change is to be captured. For example, a selection bias might occur if state ownership was introduced in the first place to shore up firms that could not compete in the market (so that state firms were handicapped from the beginning). This problem may be avoided by comparing the performance of privatised (rather than originally private) firms to that of public firms. However, selection bias may still occur if better firms were chosen for privatisation. See Frydman et al, 1997.

Boardman & Vining (1989) is by far the most important and most cited work in this category. They examined the performance of state, private and mixed enterprises in market economies, comparing the performance of the largest 500 non-US industrial corporations. The data consisted of 409 private corporations, 57 state owned enterprises, and 23 mixed enterprises having a
mixture of public and private capital. For dependent variables they used four profitability measures (return on equity, return on assets, return on sales, and net income), two productivity measures (sales per employee, and sales per asset) and a capital ratio (asset per employee). Independent variables included assets, sales, number of employees to reflect size and therefore possible scale effects, and also dummy variables were introduced to reflect market concentration, industry, country differences and ownership form. The study concluded that private firms perform better along several dimensions than both state owned and mixed firms, and that mixed firms do no better, and often worse than state owned enterprises. In spite of the obvious attempts to control for sectoral and country influences, it has been argued that the controls were not enough to exclude the selection bias hypothesis from the study. See Martin & Parker, 1997; Frydman et al, 1997.

Another important study in this category is that of Pohl et al (1997) who examined the performance of a large number of state and privatised firms in seven transition economies between 1992 and 1995, concluding with a powerful case in favour of the effectiveness of privatisation. The study however failed to deal with the possibility of selection bias and is thus potentially open to the objection that the superior performance of privatised firms it reports may be due to factors other than ownership. Other notable "synchronic" comparisons include the following studies; Hutchinson (1991); Vickers & Yarrow (1988); Bishop & Kay (1988, 1989); Yarrow (1986, 1989); Bishop & Thompson (1992, 1993); Bishop & Kay (1988, 1989); Pryke (1981); Millward (1990, 1991); Millward (1988); Tyler (1979)
Other forms of classification exist, that tend to categorise the different types of studies into three groups as follows: 1) Case studies that deal with specific firms and their evolution before and after privatisation, 2) Country-specific, cross-industry evidence that looks into performance changes for firms in different sectors within the same country, before and after privatisation, and 3) Cross-country evidence that uses data from firms that are publicly traded in different countries to evaluate changes in their financial status, before and after privatisation. See Sheshinski and Lopez-Calva, 1999. It is not possible to undertake a detailed appraisal of all available studies on the impact of privatisation, in this study. However an outline of some of the important studies conducted, areas covered, performance measures employed, and their related evidence on the effects of privatisation is presented in table 3.4 below.

**Notable performance Indicators**

A cursory look at available studies would confirm a wide usage of financial indicators in assessing the performance of firms, both public and private. The broader categories of these indicators include:

1) *Profitability*, usually calculated as (operating income / sales) or (net income / sales) or as a rate of return on capital.

2) *Productivity (operating efficiency)*, may take the form of cost per unit, sales per employee, (value added / total assets) or (value added / payroll)

3) *Output*, is represented by real sales in most studies

4) *Employment*, is basically the total number of employees

5) *Liquidity (Leverage)*, is calculated as (debt / assets) or (debt / equity)
6) *Investments*, calculated as (total capital expenditure / sales), and
7) *Dividend payout*, calculated as dividends to sales ratio or (Dividends/net income)

We may observe from table 3.4 below that most of the studies covered have employed one or more of these indicators in assessing the impact of ownership.

**Summary of Evidence**

The conclusions drawn from our sample of studies, outlined in table 3.4, tend to suggest much more evidence in support of the argument of private sector superiority that has spanned the entire length of our discussion so far. A few of the studies are however inconclusive, with mixed results that neither confirmed nor disproved the assertion that privatisation leads to improved efficiency. Studies by Millward (1988, 1990, 1991) are most noted here. Other isolated studies mainly in the utilities sector have shown results that indicate better performance in the public sector. See Lynk (1993); Bruggink (1982). However, some of the findings in favour of the public sector could not be linked directly to change in ownership. We may safely conclude that, though available studies do not provide unequivocal support for privatisation, allowance may be made for the fact that, the industries in which public sector firms seem to perform as well, or even better than the private sector mainly tend to be monopolistic and state regulated. Economic theory however suggests that state regulation may lead to inefficiency under private ownership, thus swinging the pendulum of evidence back to the superiority of private ownership in competitive markets.
Table 3.4: Summary of empirical studies on the impact of ownership on corporate performance

<table>
<thead>
<tr>
<th>STUDY: Author (year) Country</th>
<th>INDUSTRY/Studies</th>
<th>PERFORMANCE MEASURE</th>
<th>CONCLUSION ON EFFICIENCY (SUPERIOR SECTOR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Megginson Et al. (1994) 18 DCs &amp; LDCs</td>
<td>32 industries 61 Companies</td>
<td>Profitability, output, Employment, dividend payout, investment, leverage, efficiency</td>
<td>X</td>
</tr>
<tr>
<td>Vining &amp; Boardman (1992) Canada</td>
<td>14 Industries 500 companies</td>
<td>Returns on assets, Sales and net income, log of sales per employee, sales per asset.</td>
<td>X</td>
</tr>
<tr>
<td>Hutchinson (1991) The UK</td>
<td>17 firms in several industrial groupings</td>
<td>Labour &amp; capital productivity, profitability, Technology mix</td>
<td>X</td>
</tr>
<tr>
<td>Millward (1988) LDCs</td>
<td>Many</td>
<td>Technical efficiency</td>
<td>X</td>
</tr>
<tr>
<td>Borcherding Et al (1982) 5 countries</td>
<td>50 studies</td>
<td>Unit cost structures, total factor productivity, rate of return</td>
<td>X</td>
</tr>
<tr>
<td>Millward (1982) North America</td>
<td></td>
<td>Unit cost structures, total factor productivity, rate of return</td>
<td>X</td>
</tr>
<tr>
<td>Adhikari &amp; Kirkpatrick (1990) LDCs</td>
<td>Developing economies</td>
<td>Various</td>
<td>X</td>
</tr>
</tbody>
</table>
Table 3.4 cont’d: Summary of empirical studies on the impact of ownership on corporate performance

<table>
<thead>
<tr>
<th>STUDY: Author (year) Country</th>
<th>INDUSTRY/STUDIES</th>
<th>PERFORMANCE MEASURE</th>
<th>CONCLUSION ON EFFICIENCY (SUPERIOR SECTOR)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Galal et al (1992) UK, Chile, Mexico, &amp; Malaysia</td>
<td>Privatised airlines, Telecom firms, electricity utilities etc</td>
<td>Economic gains and losses to employees, taxpayers and customers</td>
<td>X</td>
</tr>
<tr>
<td>Boubakri &amp; Cosset (1998) 21 LDCs</td>
<td>79 companies</td>
<td>Return on sales, real sales, employment, sales efficiency, investment, leverage</td>
<td>X</td>
</tr>
<tr>
<td>D’Souza &amp; Megginson (1998) 16 DCs, 10 LDCs</td>
<td>78 firms from banking, utilities, and telecom sectors</td>
<td>Return on sales, real sales, employment, sales efficiency, investment, leverage</td>
<td>X</td>
</tr>
<tr>
<td>World Bank (1995) LDCs</td>
<td>Analysis of 12 developing economies</td>
<td>Various</td>
<td>X</td>
</tr>
<tr>
<td>Frydman et al (1997) Transition economies</td>
<td>Large sample of mid-sized privatised and state firms</td>
<td>Revenues, employment, revenue per employee, costs per unit of revenues</td>
<td>X</td>
</tr>
</tbody>
</table>
3.6 SUMMARY

This chapter has taken us through an in depth examination of the concept of efficiency for as far as it stands out as the overriding force behind the economic policy of privatisation. Since privatisation basically involves the transfer of ownership we devoted some attention as well to the importance of ownership and its related implications for efficiency improvements in privatised firms. This led us to the role of market structure, the importance of competition, and its intricate intermarriage with the appropriate form of ownership to produce the desired level of efficiency. Some fundamental theories underlying the ownership-efficiency debate (agency, property rights, and public choice theories) were examined, and we saw arguments flow from all three theories that tend to favour private ownership, much more than public ownership. Finally empirical evidence was sought by examining some comparative studies on the impact of privatisation (ownership) on corporate performance. Though the studies are not altogether unequivocal in their findings, evidence on private sector superiority (in terms of efficiency and economic performance) is much more overwhelming.
CHAPTER 4

AN OVERVIEW OF THE PUBLIC SECTOR OF GHANA

4.1 INTRODUCTION
The last two chapters took us through a comprehensive overview of the concept of privatisation. The two chapters took us through both theoretical and empirical literature, providing us with a general understanding of the meaning, methods and the empirical justifications for the economic concept of privatisation. Taken together, they provide us with the important background against which to examine the programme of privatisation in Ghana, which is, in fact, the focus of this study.

However, to enable us to fully appreciate the form and direction of Ghana's Divestiture Programme, it is imperative that we take a look at the history and peculiar nature of the public sector of Ghana (State-Owned Enterprises, for that matter), to the extent that they do constitute the very basis and primary ingredient for the process of privatisation.

This chapter begins with a brief profile of Ghana. It is followed by an attempt to trace the history and development of the public sector (state owned enterprises) from the pre-independence years through to the eve of the Economic Recovery Programme in 1983. We proceed to examine the
objectives and the essential components of the Economic Recovery Programme (ERP), of which privatisation is a core element.

4.2 PROFILE OF GHANA

Ghana, formerly known as the Gold Coast, obtained her independence from the British Empire on 6th March 1957. The country attained the status of a republic after three years of independence on 1st July 1960 and has since remained an active member of the British Commonwealth of nations.

The country is located on the western part of Africa. It spans 672 kilometres from south to north and covers an area of 238,533 square kilometres. The population of Ghana is over 19 million, with an annual growth rate of 3.2 per cent. Ghana is currently divided into ten administrative regions. English is the official language and the principal local languages spoken include Twi, Ewe, Ga, and Hausa.

The currency unit is the Cedi (₵). The economy of the country is based on two distinct sectors: a) a large traditional sector (principally agricultural and informal activities), and b) a relatively small, labour-intensive industrial and service sector. The economy has traditionally depended on exports of primary products with about 60 per cent of the labour force employed in agriculture. Agriculture contributes about 46 per cent to Gross Domestic Product (GDP) and is characterised by small-scale operations, principally staple food crops and cocoa production. The services sector is the second
largest employer (25 per cent of the labour force) accounting for over 40 per cent of real GDP from trade and public sector services, while the industrial sector accounts for about 14 per cent of GDP and employment.

The political history of Ghana is characterised by a number of military takeovers following the overthrow of the first elected government of Dr Kwame Nkrumah in 1966. With two brief periods of constitutional rule (i.e. a total of less than 5 years), the country has been under military rule until 1992 when a new constitution was drawn up by a consultative assembly and approved in a national referendum in April 1992. It follows the presidential executive system and guarantees democratic freedom. Both presidential and legislative elections were held in November 1992 and the administration of the country was handed over to the elected National Democratic Congress (NDC) government (under the leadership of Flt. Lt. J.J. Rawlings) in January 1993. The NDC lost power to the New Patriotic Party (after serving two 4-year terms) in elections held in December 2000. The New Patriotic Party (NPP) assumed the reins of the government at the beginning of the year 2001 on the mandate of private sector promotion, declaring a “Golden Age of Business” and an anti-corruption campaign.

4.3 THE HISTORY AND GROWTH OF THE PUBLIC SECTOR OF GHANA

The objective of this section is to trace the origins and the gradual development of the public sector (state owned enterprises) up to the start of the Economic Recovery Programme and the process of privatisation. The
discussion is carried under subsections that fall in line with the various political administrations (governments) that the country has had in its short history as a nation. This is to demonstrate the extent to which the economic policy framework of each government that had emerged in Ghana over the last four decades of its history, had had a significant influence in shaping the development of both the public and the private sectors of the economy and as a result determined the level of their contribution towards the socio-economic development of the country.

4.3.1 The Pre-Independence Period (Colonial Legacies)

It is worth noting that the process of state ownership in Ghana (then known as the Gold Coast) started during the British colonial administration. State-owned enterprises in Ghana date to the colonial period and especially to the post-World War II era, influenced more by the post-1945 British Labour Party government’s policy on nationalisation, and development strategies of the 1950s. For example, the colonial government organized a number of public utilities, such as water, electricity, postal and telegraph services, rail and road networks, and bus services. To foster exports of coffee, palm kernels, and cocoa, the Agricultural Produce Marketing Board was founded in 1949. In addition, the colonial government established the Industrial Development Corporation and the Agricultural Development Corporation to promote industries and agriculture.
4.3.2 Early Years of Independence (The Nkrumah Regime (1957-1966))

It is largely argued that the relatively dominant position of public enterprises in the Ghanaian economy can be traced directly to the vigorous expansion of state ownership in the early years of independence, under Dr. Kwame Nkrumah's (Convention People's Party) government. It is on record that Dr. Nkrumah pursued a development strategy, based on a combination of nationalism, and socialism, and supported by the economic development theories of his time, that advocated a leading role for the state in all sectors of the economy. It was largely the case that, the new rulers of Africa (after independence) sought to accumulate and centralise power, usually quite aggressively, on the basis of inherited colonial institutions. Their aims were to neutralise opponents, (especially at regional and or ethnical levels) and push forward ambitious development programmes against the backdrop of rapid industrialisation, Pan-Africanism and decolonisation. Although ideological inclinations cannot be completely ignored in his vigorous campaign of state ownership, Nkrumah's development strategy has been attributed more to sheer pragmatism rather than ideology.

It has been noted that there was no firm commitment to direct state intervention in the early years of the first republic, and indirect methods such as tariff policy and tax incentives for pioneer industries were rather employed side by side with direct interventionist measures. In March 1959 for example, the government launched a Five-Year Development Plan, and in an address to the National Assembly, Dr. Nkrumah stated among others that the plan was designed to provide the solid foundation for a welfare state and to
encourage investment that is needed to raise the standard of living of the people. However, by the time of launching its Seven-Year Development Plan in 1963, a remarkable change was observed in the development strategy of the government. It has been argued that the beginning of the 1960s saw Nkrumah breaking out of the colonial mould and switching decisively to a socialist strategy, rejecting an open market oriented economy and instituting a planned, regulated and centralised economy, in which the state was to become the predominant economic agent and the pursuit of development was to be given priority.

It has been argued further that Dr. Nkrumah had little confidence in the private sector and believed that the private sector was unable, and often unwilling, to initiate the modernisation (mechanisation) of agriculture, as well as the rapid industrialisation that he saw as essential ingredients for Ghana's development\(^{20}\). See Killick, 1978; Asante, 1987; Sandbrook, 1988; Adda 1989; Akuoko-Frimpong, 1990. (See table 4.1 below)

As a result, the period between 1960-1966 under Dr Nkrumah saw the establishment of the largest number of (most of what we have today as) state owned enterprises. The list includes some of the core SOEs namely, Volta River Authority, Ghana Airways Corporation, State Fishing Corporation, State Gold Mining Corporation (Now Ashanti Goldfields Company), Ghana National trading Corporation, State Farms Corporation, and a large number of

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manufacturing firms that subsequently became divisions of the now defunct Ghana Industrial Holding Corporation (GIHOC).

4.3.3 National Liberation Council / Progress Party (1966-1972)

The period between 1966 and 1972 saw a significant de-emphasis in the role of government in economic activity. The overthrow of the Government of the First Republic in February 1966 marked the beginning of a new era in the development of both public and private enterprises in the economy of Ghana. This period covered two separate regimes. The National Liberation Council (NLC) (1966-1969) and the Progress Party (PP) (1969-1972). Taken together, these two regimes have been noted for their reactionary stance in rejecting close to everything that Nkrumah had sought to do and systematically reversing most of his economic policies. It is argued that they rejected the idea of socialism, planning and controls and turned to a strategy that put stability above growth, re-opened the economy, and returned to a private enterprise, market-oriented and decentralised system. The state was increasingly disengaged from direct participation and control, and instead regulated the economy indirectly through the medium of the market.

Of particular importance to this study and perhaps the most significant evidence of policy change is what may be described as the first recorded attempt at privatisation in Ghana, by the military government of the NLC (1966-1969). Out of fifty-three (53) state-owned enterprises, twenty (20) were earmarked for divestiture (put on the 'sell' list). Seven (7) out of the 20,
were listed for outright sale, and the 13 others marked for joint-ventureships. The programme could not be fully implemented however, as only 4 minor firms were actually sold. The major set back was the public outcry and vehement reaction against the proposed sale of the State Pharmaceutical Factory to a private firm known as Abbot Laboratories Ltd. The withdrawal of the sale offer to Abbot Laboratories closed the chapter to Ghana’s first efforts at privatising the economy. The insignificance of the 4 firms actually privatised notwithstanding, the attempt per se did place Ghana on the map as one of the few countries (world wide) to have embarked on a privatisation drive, long before it became a universally accepted policy for economic growth and development.

On the other hand, the government of the Progress Party (1969-1972) (under the leadership of Dr. Busia), pursued economic policies that were seen largely as a continuation of what the NLC (1965-1969) had started, even though the fundamental objectives were not very different from those of Nkrumah. In its One-Year development Plan of 1970, for example, the Busia government acknowledged its primary responsibility for improving the living standards and the quality of life of its citizens, and recognised foreign private capital and the establishment of joint state/private enterprises as the basic approach to meeting these objectives. The government was particularly noted for the promotion of economic nationalism. Notable measures taken in this direction include the implementation of the NLC government’s Ghanaian Enterprises Decree of 1968, which sought to promote and stimulate the active involvement of Ghanaians in the modern sector of the economy. The
subsequent Ghanaian Business Promotion Act (334) of 1970 was directed at the same objective but then sought to restrict certain sectors of the economy as solely for Ghanaian participants. Not surprisingly, all subsequent governments, irrespective of their political or ideological inclinations, have maintained this policy over the years. The Progress Party government is also noted for its Aliens Compliance Order of 1969 that saw to the expulsion of a number of aliens from Ghana, with the aim of creating opportunities for indigenous entrepreneurs to enter sectors of the economy previously dominated by these aliens.

The foregoing discussion notwithstanding, the importance of state-owned enterprises for some strategic, political, and socio-economic reasons could not be totally ignored by these two administrations. Thus, in spite of the remarkable shift away from the public sector (towards the private sector), the era saw some additions as well to the number of state-owned enterprises. The most important among these firms are the Electricity Corporation of Ghana, Ghana Food Distribution Corporation, and the Ghana Tobacco Company. See Killick, 1978; Asante, 1987; Sandbrook, 1988; Adda 1989; Akuoko-Frimpong, 1990). (See table 4.1 below)

4.3.4 The National Redemption Council/ Supreme Military Council (1972-1979)

The Busia government's experiment with the 'free market economy' was perceived to have failed, giving grounds for a second military takeover by the National Redemption Council (NRC) (later transformed in 1975 into the
Supreme Military Council (SMC)). Soon after seizing power in January 1972, the NRC/SMC government signaled a return to development strategies and policies of the Nkrumah era, including a renewed drive towards greater direct participation of the government in the economy. In a move to gain control of all vital economic activities, i.e. to ‘occupy the commanding heights of the economy’, the government, soon after takeover, took a majority interest in all large mining and timber companies, which after cocoa, were the principal sources of export earning for the country. This was followed in 1975 by the government’s Investment Policy Decree, which required all foreign enterprises to become joint ventures with either private Ghanaians or with the state as partners\textsuperscript{21}. The re-emphasis of the role of the state as an entrepreneur was clearly demonstrated by the government’s acquisition of 55 per cent shares in a number of foreign owned companies in several sectors of the economy.

The NRC/SMC government did not abandon the private sector however. The government recognised that the private sector was capable of playing a most vital role in Ghana’s socio-economic development efforts. Hence in its Five-Year development Plan (1975/76 – 1979/80), the government not only expected the role of the private sector to increase to a much faster pace so that its contribution to both national output and employment would be greater, but also sought to strengthen the facilities offered by various institutions set up to aid private investors in the economy. On the whole, the government’s declared policy of capturing the commanding heights of the economy led to

\textsuperscript{21} NRC Decree (NRCD) 392, Accra, 1975.
the creation of a number of joint state-private enterprises with foreign as well as indigenous entrepreneurs in which both the state and Ghanaians had substantial shareholdings.

4.3.5 The Armed Forces Revolutionary Council (1979)

The Armed Forces Revolutionary Council (AFRC) led by Flt. Lt. J.J. Rawlings overthrew the SMC administration in June 1979, bringing in its wake a revived government involvement in economic activity. Though very brief, the era of the AFRC (June 1979 – October 1979) witnessed a massive confiscation of private enterprises whose owners had been accused of financial and/or economic 'crimes' against the state. With the exception of the Achimota Brewery Company (then known as Tata Brewery Company Ltd.), most of the assets confiscated were relatively small manufacturing firms, the most notable being the National Industrial Company Limited (NICOM Group of Companies), Ghamot Company limited (formerly Fattal Brothers Ltd), George Amuah and Associates (GEA) Group of Companies. Thus by the time of handing over to the newly elected civilian government of the People’s National Party, in October 1979, the AFRC had added significantly to the already large number of SOEs.

4.3.6 The People’s National Party (1979-1981)

The economic policies of the People’s National Party (PNP) led by Dr Hilla Limann were largely seen as a continuation of some of the unfolding policies of the NRC/SMC. Another credible observation was that, in spite of the PNP’s claim to be a direct successor to the legacy of Nkrumah’s Convention
People's Party, (i.e. in terms of ideological orientation), the attitude of the Limann administration towards state ownership bore some semblance of the Busia administration. The PNP administration was however short-lived and most of its proposed strategies did not see the light of day. Nevertheless, the observed attitude of the government was significant, in that, it marked the beginning of a national consensus on the expected role of both the public and private sectors in the Ghanaian economy. In this regard, it may be argued that the Limann administration’s Investment Code of 1981 designed to open up the economy to uninhibited foreign investment and to guarantee the investor the necessary incentives, provided the economic policy framework for the enactment of the PNDC government’s Investment Code of 1985 (PNDCL 116), which has significantly impacted on Ghana’s efforts at re-assigning the relative roles of the public and private sectors of the economy.

4.3.7 The Provisional National Defence Council (1981-1992)

31st December 1981 marked a significant turning point in the political and more importantly the economic history of Ghana. This day saw the overthrow of the PNP administration and the return to power of Flt. Lt. J.J Rawlings and his newly formed Provisional National Defence Council (PNDC) government. Enjoying the support of workers and the lower classes of society, Rawlings injected a populist, revolutionary spirit into Ghanaian politics, and experimented briefly with eastern socialist ideals during his first year in office. At the beginning of 1983 however, the government was compelled by worsening economic conditions to abandon its radical economic policies, to
become the first government in Africa to accept the World Bank / IMF reform programmes. The nature and impact of the Economic Reform Programme (ERP) is of particular importance to this study (especially with regard to public/private sector changes) and is thus given a more detailed attention under section 4.5

Table 4.1 below shows a breakdown of the number of state-owned enterprises as at the beginning of 1983 indicating the relative contribution of each of the past governments to the growth of the public sector.

<table>
<thead>
<tr>
<th>Year of State Participation</th>
<th>Government</th>
<th>Percentage of sample (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1960</td>
<td>Mainly colonial legacies</td>
<td>10</td>
</tr>
<tr>
<td>1960-1966</td>
<td>CPP</td>
<td>25</td>
</tr>
<tr>
<td>1967-1971</td>
<td>NLC / PP</td>
<td>11</td>
</tr>
<tr>
<td>1972-1975</td>
<td>NRC</td>
<td>24</td>
</tr>
<tr>
<td>1976-1978</td>
<td>SMC</td>
<td>7</td>
</tr>
<tr>
<td>1979 and after</td>
<td>AFRC/ PNP /PNDC</td>
<td>23</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td>100</td>
</tr>
</tbody>
</table>

Source: IBRD Report, 1985 (Modified)
4.4 STATE OF THE PUBLIC SECTOR ENTERPRISES BEFORE THE ECONOMIC REFORMS PROGRAMME

The culminating effect of the changing attitudes and policies of various governments towards the public sector over the years is an expanded public sector, made up of nearly 300 SOEs as at the start of the divestiture programme in 1988. In this section, we shall attempt to take a 'snapshot' view at the general state of the state-owned enterprises as at the start of the economic recovery programme and before the eventual process of divestiture. We shall take a brief look at the objectives, structure of ownership, relative performance, and for that matter the justification for divesture.

Objectives of the SOEs

The term SOEs in the Ghanaian context agrees with our definition in chapter two, and refers to an enterprise that is engaged in the production of goods and services for sale; in which sales revenues do bear some relationship with costs; and in which the government owns either all or at least the majority of shares. See Adda (1989). Again, the objectives for setting up SOEs in Ghana are just as discussed in chapter two. That is primarily: a) to ensure the governments controlling interest in the national economy, b) to promote public entrepreneurship in areas where private capital was unavailable or
considered too risky for private investment, c) to offer competition to private enterprise and thereby ensure the stabilisation of prices, d) to create employment opportunities for the jobless, and e) to ensure equitable distribution within the geographical entities and to rectify social and regional imbalances. The economic expectations of governments in creating these SOEs may be summed up in the statement made by Dr Kwame Nkrumah thus:

I must make it clear that these state enterprises were not set up to lose money at the expense of the taxpayers. Like all business undertakings, they are expected to maintain themselves efficiently, and show profits. Such profits should be sufficient to build up capital for further investment as well as to finance a large proportion of the public services, which it is the responsibility of the state to provide. (Dr. Kwame Nkrumah)

In effect, the SOEs were expected to operate as commercial entities and to generate revenue for the development of social services. The state expects them to provide reasonable financial returns on investment, provide goods and services to the population at reasonable prices, ensure regular income to the workers, and generally act as a focus for the development process by generating the necessary revenues to support the national budget. See Adda, 1989; Shirley 1986.

General Structure of ownership

Almost all the wholly government owned SOEs (the confiscated ones excluded) were incorporated either under the Statutory Corporations Act or by one form of Legislative/ Executive Instrument or the other. Government ownership has generally taken three basic forms: a) direct majority

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shareholding, b) indirect ownership through holding companies, and c) joint ventures.

As at the beginning of the second phase of the Economic Recovery Programme (i.e. ERP II) in 1987, the government had shareholdings in at least 235 enterprises. Out of this number, it had majority shareholding and hence controlling interest in a total of 181 (77 per cent) of these enterprises. This leaves 54 (23 per cent) enterprises in which the government had minority interests and thus leaving their control in the hands of the private sector. Further, out of the 181 firms in which the government had majority shares, 93 (i.e. 39.6 per cent of the total number of public enterprises) represented direct majority holdings, whereas the remaining 83 (35.3 per cent) were indirectly held through other state owned financial and non-financial enterprises. The major financial institutions that held shares (as well as other subsidiaries) included the National Investment Bank, Agricultural Development Bank, Bank for Housing and Construction, and the Bank of Ghana which had investments in six enterprises, three of them wholly owned. The non-financial SOEs that held shares in other enterprises included the Ghana Industrial Holding Corporation (GIHOC), which had 24 subsidiaries (with majority shares in 22 of them, and minority shares in the other two). The others are the National Industrial Company, The State Gold Mining Corporation, and the Ghana Cocoa Board. Additionally, government has also been involved in a number of joint ventures with private partners (mainly foreign). Among the 23 ventures with foreign partners, the government had a
controlling interest, directly or indirectly in 15 of the firms. Table 4.2 below gives us a breakdown of the structure of government ownership.

Table 4.2 General structure of state ownership of SOEs

<table>
<thead>
<tr>
<th>NATURE AND EXTENT OF STATE HOLDING</th>
<th>NO. OF ENTERPRISES</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Majority State Holding</strong></td>
<td></td>
</tr>
<tr>
<td>Direct Majority Holding</td>
<td>95</td>
</tr>
<tr>
<td>Direct /Indirect Majority Holding</td>
<td>5</td>
</tr>
<tr>
<td>Indirect Majority Holding</td>
<td>83</td>
</tr>
<tr>
<td><strong>Sub-total</strong></td>
<td><strong>181</strong></td>
</tr>
<tr>
<td><strong>Minority Shareholding</strong></td>
<td></td>
</tr>
<tr>
<td>Direct Minority Holding</td>
<td>12</td>
</tr>
<tr>
<td>Indirect Minority Holding</td>
<td>42</td>
</tr>
<tr>
<td><strong>Sub-total</strong></td>
<td><strong>54</strong></td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>235</strong></td>
</tr>
</tbody>
</table>


Role and Performance of the SOEs

In line with the objectives noted above, SOEs had been established in virtually all sectors of the economy with a complete dominance of the utilities sector (notably, electricity, water, power generation telecommunications etc). SOEs presence had also been particularly strong in the mining, timber and
other key areas of economic activity. Virtually all of Ghana's exports were produced by, or marketed by SOEs. The bulk of these products (cocoa beans and cocoa products) were marketed through the Ghana Cocoa Board and its subsidiaries. The extraction and marketing of gold and other minerals were mainly in the hands of five state-owned or state-controlled mining companies. Although a few private firms operated in the timber sector, exports were in the main channelled through the four major SOEs established for the purpose.

Other economic activities with notable public sector dominance include the supply of agricultural inputs (e.g. the distribution of fertilizers), rail and air transport, all bulk imports, the oil refinery, and a large chain of retail outlets (through the Ghana National Trading Corporation). The manufacturing sector was not left out. The production of many essential commodities was controlled by the state by maintaining a controlling interest in the major manufacturing units. It has been estimated that as at 1982, the government had a controlling interest in 86 (22 per cent) of all large and medium-scale manufacturing enterprises, accounting for more than half of the total employment and output of those firms. See World Bank, (1985). (See tables 4.3 and 4.4 below)
Table 4.3: State participation in selected SOEs

<table>
<thead>
<tr>
<th>ENTERPRISES</th>
<th>% OF STATE HOLDING</th>
<th>NO. OF EMPLOYEES (DECEMBER, 1984)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ashanti Goldfields Corporation Ltd.</td>
<td>55</td>
<td>11,137</td>
</tr>
<tr>
<td>Ghana Bauxite Company Ltd</td>
<td>55</td>
<td>500</td>
</tr>
<tr>
<td>Juapong Textiles Ltd</td>
<td>55</td>
<td>1,314</td>
</tr>
<tr>
<td>Ghacem Ltd</td>
<td>75</td>
<td>676</td>
</tr>
<tr>
<td>Overseas Knitwear Fabrics Ltd</td>
<td>60</td>
<td>62</td>
</tr>
<tr>
<td>Two worlds Manufacturing Co. Ltd</td>
<td>60</td>
<td>16</td>
</tr>
<tr>
<td>Willowbrook (Ghana) Ltd</td>
<td>55</td>
<td>203</td>
</tr>
<tr>
<td>Neoplan (Ghana) Ltd</td>
<td>55</td>
<td>460</td>
</tr>
<tr>
<td>Gliksten (West Africa) Ltd.</td>
<td>55</td>
<td>1,068</td>
</tr>
<tr>
<td>African Timber and Plywood Ltd.</td>
<td>55</td>
<td>1,471</td>
</tr>
<tr>
<td>Ejura Farms (Ghana) Ltd</td>
<td>91</td>
<td>100</td>
</tr>
<tr>
<td>Takoradi Veneer &amp; Lumber Co. Ltd</td>
<td>55</td>
<td>725</td>
</tr>
<tr>
<td>Tomos (Ghana) Ltd</td>
<td>55</td>
<td>121</td>
</tr>
<tr>
<td>Bibiani Industrial complex Ltd. (Metal)</td>
<td>80</td>
<td>14</td>
</tr>
<tr>
<td>Plant Pool Ltd</td>
<td>60</td>
<td>240</td>
</tr>
<tr>
<td>Tema Textiles Ltd.</td>
<td>60</td>
<td>1,131</td>
</tr>
</tbody>
</table>

### Table 4.4: Recorded employment from selected SOEs

<table>
<thead>
<tr>
<th>Recorded Employment in 1979 ('000)*</th>
<th>Private sector</th>
<th>SOEs</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cocoa &amp; Agriculture</td>
<td>2.9</td>
<td>71</td>
<td>73.9</td>
</tr>
<tr>
<td>Mining</td>
<td>13.3</td>
<td>10.7</td>
<td>24.0</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>60.6</td>
<td>19.2</td>
<td>79.8</td>
</tr>
<tr>
<td>Electricity and Water</td>
<td></td>
<td>15.9</td>
<td>15.9</td>
</tr>
<tr>
<td>Construction</td>
<td>11.4</td>
<td>17.1</td>
<td>28.5</td>
</tr>
<tr>
<td>Trade and Hotels</td>
<td>15.5</td>
<td>16.1</td>
<td>31.6</td>
</tr>
<tr>
<td>Transport and Communications</td>
<td>1.9</td>
<td>16.9</td>
<td>18.8</td>
</tr>
<tr>
<td>Others</td>
<td>17.2</td>
<td>192.4</td>
<td>209.6</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>122.8</strong></td>
<td><strong>359.3</strong></td>
<td><strong>482.1</strong></td>
</tr>
</tbody>
</table>


* This table covers establishments employing 10 or more people. This includes public institutions of a non-commercial nature. Data for the private sector includes joint state/private enterprises. (World Bank, 1985)

The rationale for creating these state owned enterprises appears laudable at a glance and SOEs had constituted a considerable part of government machinery over the years. However, the performance of these firms in whatever roles they had been created to perform had on the whole fallen below expectation. Rather than contribute to government revenue, the public sector has rather become a great burden on government (especially, in terms
of indirect support through tax and loan arrears, non-payment of dividends and, in some cases, inability to repay government-guaranteed foreign loans).

For example, government support for SOEs increased from ₋1.1 billion cedis in 1982 (i.e. 10 per cent of government expenditure) to ₋7.35 billion in 1986 (about 8 per cent). SOE tax arrears doubled from ₋1.27 billion in 1984 to ₋2.5 billion in 1985. Further, outstanding government loans to SOEs increased from ₋500 million in 1982 to ₋1.9 billion in 1985. There has been complete default in both interest and principal repayments of these loans over the years. For example, over the 5-year period 1979 – 1984, SOEs repaid only ₋45 million in principal and ₋7.3 million in interest on their outstanding loans, at an effective interest rate of less than 1 per cent.

Government has generally not been able to directly finance substantial capital investment by SOEs, through loans and equity, and some SOEs have had to finance their expansions from foreign loans that are guaranteed by the government. Figures available as at 30 June 1986 conclusively show that government-guaranteed loans from external and internal sources for only 18 SOEs was close to ₋15.681 billion, according to the State Enterprises Commission (SEC) Cross-Debt studies. In 1982 for example, transfers to SOEs by government accounted for 13 per cent of government expenditure.

This shot up to about 25 per cent by the end of 1984, and took the form of subsidies, equity contributions and capital grants.

---

23 Data obtained from the Ministry of Finance and Economic Planning and also from the State Enterprises Commission.
See also Adda, W. (1989)
The argument thus continues that in economic terms, it is not the actual size of these SOEs that really matter but rather, the question should be whether these firms operate efficiently and achieve their objectives in a cost effective way. On the whole the financial performance of the public sector has been generally poor. Altogether, about 43 per cent of SOEs in the economy have been shown to operate at a net loss in each year of the period 1979 – 1983. For instance the loss, before tax and excluding subventions, amounted to $92 million in 1979, and rose to $2.8 billion in 1982 (i.e. 9 times the 1979 loss after allowing for inflation as illustrated in table 4.5 below. See World Bank (1985)

**Table 4.5: Operating Results of a Sample of SOEs, 1979-1983**

(¢ million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Operating Results (before tax and including subventions)</td>
<td>194.6</td>
<td>285.5</td>
<td>-13.0</td>
<td>-2165.0</td>
<td>8,000.3</td>
</tr>
<tr>
<td><strong>Less</strong> Subventions</td>
<td>286.4</td>
<td>371.8</td>
<td>618.5</td>
<td>728.9</td>
<td>8,551.2</td>
</tr>
<tr>
<td>Operating Results (excluding subventions)</td>
<td>-91.8</td>
<td>-86.3</td>
<td>-631.5</td>
<td>-2893.9</td>
<td>-550.9</td>
</tr>
<tr>
<td>Operating Results in constant (1979) Prices</td>
<td>-95.3</td>
<td>-57.5</td>
<td>-233.3</td>
<td>-831.8</td>
<td>-72.4</td>
</tr>
<tr>
<td>As a % of sales</td>
<td>-4.4</td>
<td>-1.2</td>
<td>-12.0</td>
<td>-49.2</td>
<td>-7.4</td>
</tr>
</tbody>
</table>

Operating losses continued to increase sharply in the 1980s, leading to serious liquidity problems for most SOEs, with increasing arrears to government, other creditors and suppliers. For example, a cross-debt study on 18 SOEs (about 8 per cent of all SOEs) undertaken by the State Enterprises Commission in early 1987, reported cross debts between SOEs totalling $5.2 billion, and showed their indebtedness to the government to be $40.2 billion (made up of taxes $6.0 billion, unpaid dividends $85.0 million, and domestic and foreign loans $2.7 billion and $31.4 billion respectively).

See Adda, (1989). Available data indicates that, the ratio of current assets to current liabilities (current ratio) for all SOEs combined fell from 1.48 in 1979 to 0.74 in 1982, indicating a sharp downward trend as shown in table 4.6 below.

Among the individual sectors, cocoa marketing, mining, manufacturing and construction were noted to be particularly vulnerable, with the Cocoa Board and its subsidiaries showing a current ratio of only 0.23 in 1982, which led to a subsequent debt write off in the same year. It is further noted (World Bank Report, 1985) that the marked improvement in the ratios for the mining companies in 1983 was largely the outcome of a currency devaluation that resulted in better cash flows for those enterprises. The agriculture, electricity and water, trade and hospitality sectors generally had satisfactory current ratios.
Table 4.6: Current Ratios in a sample of SOEs by sector (1979 – 1983)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>1.21</td>
<td>1.60</td>
<td>1.20</td>
<td>1.66</td>
<td>1.32</td>
<td>7</td>
</tr>
<tr>
<td>Cocoa</td>
<td>1.98</td>
<td>1.10</td>
<td>1.17</td>
<td>0.23</td>
<td>2.05</td>
<td>5</td>
</tr>
<tr>
<td>Mining</td>
<td>1.53</td>
<td>1.32</td>
<td>1.22</td>
<td>0.70</td>
<td>1.26</td>
<td>5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1.52</td>
<td>1.22</td>
<td>1.05</td>
<td>0.95</td>
<td>1.12</td>
<td>46</td>
</tr>
<tr>
<td>Electricity &amp; Water</td>
<td>1.43</td>
<td>1.26</td>
<td>1.45</td>
<td>1.22</td>
<td>1.19</td>
<td>3</td>
</tr>
<tr>
<td>Construction</td>
<td>1.34</td>
<td>1.36</td>
<td>1.07</td>
<td>0.81</td>
<td>1.08</td>
<td>2</td>
</tr>
<tr>
<td>Trade and Hotels</td>
<td>1.49</td>
<td>1.41</td>
<td>1.31</td>
<td>1.39</td>
<td>1.00</td>
<td>13</td>
</tr>
<tr>
<td>Transport &amp; Communications</td>
<td>1.12</td>
<td>0.95</td>
<td>0.93</td>
<td>1.10</td>
<td>1.30</td>
<td>9</td>
</tr>
<tr>
<td>Others</td>
<td>1.18</td>
<td>0.95</td>
<td>0.80</td>
<td>0.66</td>
<td>1.09</td>
<td>4</td>
</tr>
<tr>
<td>TOTAL</td>
<td>1.48</td>
<td>1.16</td>
<td>1.16</td>
<td>0.74</td>
<td>1.55</td>
<td>94</td>
</tr>
</tbody>
</table>


On the other hand, it has been noted that, the true picture of the financial position of most SOEs had largely been obscured by wrong methods of asset valuation. Most of these firms showed negative net worth on their balance sheets, indicating that they were technically bankrupt. Firms like the State Construction Corporation, the State Housing Corporation, and the State Gold Mining Corporation had liabilities that were far in excess of their assets. A revaluation of assets undertaken by some SOEs in 1983 did raise their asset value to a multiple of their previous levels but was still insufficient to cover the liabilities of most of these firms. (World Bank, 1985)
Again the operating costs of most SOEs had generally been understated in two respects. First assets have been undervalued and provisions for depreciation have therefore been extremely low. In 1984 for example, 5 SOEs (Ghana Airways Corporation, Ghana National Trading Corporation, State Fishing Corporation, State Hotels Corporation, and Tema Food Complex Corporation) made an estimated loss of ₳455 million as a result of inadequate depreciation charges. So grave was the situation that as at the middle of 1985, the Bank of Ghana held for 14 SOEs only ₳3 million in depreciation account. Apparently, the SOEs, apart from the low depreciation charges, have not been depositing the amounts into the depreciation account as demanded by law. See Bank of Ghana (1985).

Investment activity by the public sector had been very low particularly for the ten-year period preceding the Economic Recovery Programme. Between 1979 and 1983 for example, investment dropped dramatically from 6.7 per cent to only 3.8 per cent of GDP.

This figure was however accounted for by just a sample of the SOEs about whom information was made available; thus the actual figure could have been higher. Table 4.7 gives us a picture of some new fixed investments made by selected SOEs between 1979 and 1983.
Table 4.7: New Investment by selected SOEs (1979 – 1983)  
(¢ Million of current prices)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of Firms in Sample</strong></td>
<td>43</td>
<td>84</td>
<td>99</td>
<td>95</td>
<td>63</td>
</tr>
<tr>
<td>1. New fixed Investment by selected SOEs</td>
<td>446</td>
<td>665</td>
<td>871</td>
<td>837</td>
<td>1200</td>
</tr>
<tr>
<td>2. Total Gross Fixed Investment</td>
<td>1,889</td>
<td>2,613</td>
<td>3,430</td>
<td>3,053</td>
<td>7,283</td>
</tr>
<tr>
<td>1 as % of 2</td>
<td>23.5</td>
<td>25.4</td>
<td>25.4</td>
<td>27.4</td>
<td>16.5</td>
</tr>
</tbody>
</table>


It is worthy to note that while the SOEs in most economic sectors incurred losses during the period (1979 –1983), the trade and hotels sector was consistently profitable. The largest losses occurred in the cocoa sector (the Cocoa Marketing Board and its subsidiaries). Between 1979 and 1982 deficit for the cocoa sector alone far exceeded that of all other sectors put together. Available figures indicate that in 1982, 51 out of 90 state-owned enterprises made considerable losses, the major losers being the State Gold Mining Corporation, Ghana water and Sewerage Corporation, Ghana Food Distribution Corporation, and Ghana Railways Corporation. It has been shown that, the profit to sales ratio (profit margin) for all SOEs was negative and ranged from −1.2 per cent in 1980 to -49 per cent in 1982. This demonstrated extreme volatilities within sectors with large fluctuations (upwards and downwards) from year to year. (See tables 4.8, 4.9, and 4.10 below)
Table 4.8: Operating Results of a Sample of SOEs by Sector. (1979-1983)  
(¢ Million)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number of SOEs in sample</strong></td>
<td>81</td>
<td>98</td>
<td>99</td>
<td>95</td>
<td>63</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-21.7</td>
<td>-19.4</td>
<td>70.6</td>
<td>-52.5</td>
<td>13.5</td>
</tr>
<tr>
<td>Cocoa</td>
<td>-141.0</td>
<td>-209.7</td>
<td>-493.6</td>
<td>-2,448.2</td>
<td>-541.3</td>
</tr>
<tr>
<td>Mining</td>
<td>67.0</td>
<td>200.1</td>
<td>23.0</td>
<td>-306.5</td>
<td>-346.0</td>
</tr>
<tr>
<td>Electricity and Water</td>
<td>19.6</td>
<td>-13.4</td>
<td>-99</td>
<td>-44</td>
<td>-125.5</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>17.5</td>
<td>-47.2</td>
<td>-7.3</td>
<td>-28.9</td>
<td>110.8</td>
</tr>
<tr>
<td>Construction</td>
<td>-1.0</td>
<td>-7.6</td>
<td>-58.1</td>
<td>-81.2</td>
<td>1.6</td>
</tr>
<tr>
<td>Trade and Hotels</td>
<td>42.8</td>
<td>80.9</td>
<td>73.9</td>
<td>141.9</td>
<td>370.7</td>
</tr>
<tr>
<td>Transport &amp; Communications</td>
<td>-78.2</td>
<td>-61.9</td>
<td>-186.9</td>
<td>-65.0</td>
<td>-43.5</td>
</tr>
<tr>
<td>Others</td>
<td>2.5</td>
<td>-8.0</td>
<td>-11</td>
<td>9.0</td>
<td>8.7</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>91.8</td>
<td>-86.3</td>
<td>-631.5</td>
<td>-2,893.8</td>
<td>-550.9</td>
</tr>
</tbody>
</table>

### Table 4.9: SOEs Making Major Losses and Profits in 1982

(¢ Million)

<table>
<thead>
<tr>
<th>SOEs Making Losses</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>State Gold Mining Corporation</td>
<td>204.0</td>
</tr>
<tr>
<td>Ghana Water and Sewerage Corporation</td>
<td>155.2</td>
</tr>
<tr>
<td>Food Distribution Corporation</td>
<td>73.4</td>
</tr>
<tr>
<td>Ghana railways Corporation</td>
<td>73.3</td>
</tr>
<tr>
<td>State Housing Corporation</td>
<td>51.8</td>
</tr>
<tr>
<td>Post &amp; Telecommunications Corporation</td>
<td>48.9</td>
</tr>
<tr>
<td>Ghana Consolidated Diamonds Ltd</td>
<td>45.3</td>
</tr>
<tr>
<td>Ashanti Goldfields Corporation Ltd</td>
<td>38.1</td>
</tr>
<tr>
<td>State Construction Corporation</td>
<td>29.4</td>
</tr>
<tr>
<td>Ghana National Trading Corporation</td>
<td>23.6</td>
</tr>
<tr>
<td>Omnibus services Authority</td>
<td>21.2</td>
</tr>
<tr>
<td>West Africa Mills Ltd.</td>
<td>20.0</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>784.2</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SOEs Making Profits</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ghana National Procurement Agency</td>
<td>122.3</td>
</tr>
<tr>
<td>Electricity Corporation of Ghana</td>
<td>87.3</td>
</tr>
<tr>
<td>Volta River Authority</td>
<td>48.0</td>
</tr>
<tr>
<td>State Transport Corporation</td>
<td>28.0</td>
</tr>
<tr>
<td>City Express Services</td>
<td>47.4</td>
</tr>
<tr>
<td>Ghacem Ltd</td>
<td>17.3</td>
</tr>
<tr>
<td>Meat Marketing Board</td>
<td>16.3</td>
</tr>
<tr>
<td>Ghaip</td>
<td>15.0</td>
</tr>
<tr>
<td>State Hotels Corporation</td>
<td>12.4</td>
</tr>
<tr>
<td>State Fishing Corporation</td>
<td>10.7</td>
</tr>
<tr>
<td>Ghana Oil Company Ltd</td>
<td>9.9</td>
</tr>
<tr>
<td>Ghana Food Distribution Corporation</td>
<td>9.3</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td><strong>423.9</strong></td>
</tr>
</tbody>
</table>

Table 4.10: Profit Margins of a sample of SOEs by sector (1979 – 1983) (%)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture</td>
<td>-157.2</td>
<td>-25.8</td>
<td>-82.2</td>
<td>-34.2</td>
<td>3.1</td>
</tr>
<tr>
<td>Cocoa</td>
<td>-</td>
<td>-14.5</td>
<td>-35.0</td>
<td>-</td>
<td>-22.7</td>
</tr>
<tr>
<td>Mining</td>
<td>26.3</td>
<td>32.9</td>
<td>4.1</td>
<td>-68.8</td>
<td>-80.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>1.8</td>
<td>-5.4</td>
<td>-0.6</td>
<td>-3.1</td>
<td>8.2</td>
</tr>
<tr>
<td>Electricity and Water</td>
<td>9.8</td>
<td>-5.2</td>
<td>-19.5</td>
<td>-7.9</td>
<td>-52.2</td>
</tr>
<tr>
<td>Construction</td>
<td>-1.7</td>
<td>-12.6</td>
<td>-67.3</td>
<td>-73.9</td>
<td>1.8</td>
</tr>
<tr>
<td>Trade and Hotels</td>
<td>16.4</td>
<td>10.2</td>
<td>7.4</td>
<td>9.1</td>
<td>17.7</td>
</tr>
<tr>
<td>Transport and Comm.</td>
<td>-21.2</td>
<td>-13.7</td>
<td>-47.7</td>
<td>-9.1</td>
<td>-11.2</td>
</tr>
<tr>
<td>Others</td>
<td>15.0</td>
<td>21.1</td>
<td>-24.3</td>
<td>-15.4</td>
<td>43.5</td>
</tr>
<tr>
<td>TOTAL</td>
<td>-4.4</td>
<td>-1.2</td>
<td>-12.0</td>
<td>-49.2</td>
<td>-7.4</td>
</tr>
</tbody>
</table>


Reasons for the poor performance of SOEs

Several factors have been identified as contributing to the abysmal performance of the SOEs over the years. Adda (1989) lists some of the more specific reasons as follows:

1. Constraints attributable to inadequacies, inconsistencies, and the lack of clarity in government policies for the public sector;
2. The sheer oversize of the sector, in relation to available management capacity;
3. Too frequent changes in top management personnel, resulting, among other things, in instability and deviations in the pursuit of enterprise objectives;
4. Lack of adequate managerial skills;
5. Excessive political interference in the day to day operations of the enterprises;
6. Lack of adequate incentives to stimulate higher performance and productivity;
7. Ineffective monitoring and evaluation of enterprise performance;
8. Inadequate capitalisation and working capital;
9. Lack of adequate inputs as well as disruptions in input delivery;
10. Stifling of entrepreneurship arising from excessive governmental regulation or controls, as well as protectionism in the form of subsidies, government guarantees for loans, etc; and
11. The adoption of outmoded accounting and financial management systems.
12. Over staffing.

On the whole, the complexity of the problems enumerated above, impinged on the performance of the SOEs making them largely inefficient and unable to compete with their private counterparts. Table 4.11 below gives a summary of some indicators of the SOE's performance for the few years preceding the privatisation programme. Thus was the situation when the Government launched the Divestiture programme, as part of the wider Structural Adjustment Programme (SAP), which was in fact Phase 2 of the Economic Recovery Programme, started in 1983. In the next sub-section, we take a brief look at the Economic Recovery Programme.
Table 4.11: Some indicators of SOE performance in the years preceding Privatisation

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</tr>
</thead>
<tbody>
<tr>
<td>SOE Share of Domestic Investment</td>
<td>%</td>
<td>27.6</td>
<td>26.2</td>
<td>28.7</td>
<td>17.4</td>
<td>25.0</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Share of Formal Sector employment</td>
<td>%</td>
<td>55.0</td>
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</tr>
<tr>
<td>Number of people employed (000s)</td>
<td>65.6</td>
<td>60.0</td>
<td>58.8</td>
<td>180.0</td>
<td>160.0</td>
<td>104.9</td>
<td></td>
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</tr>
<tr>
<td>Share of Domestic Credit Outstanding</td>
<td>%</td>
<td>20.7</td>
<td>21.9</td>
<td>36.6</td>
<td>4.1</td>
<td>8.8</td>
<td>21.0</td>
<td>17.0</td>
<td>18.6</td>
</tr>
<tr>
<td>Share of External Debt outstanding</td>
<td>%</td>
<td>15.2</td>
<td>17.3</td>
<td>18.3</td>
<td>5.9</td>
<td>17.5</td>
<td>16.1</td>
<td>12.9</td>
<td>14.8</td>
</tr>
<tr>
<td>Net Financial results $Million</td>
<td>-86.3</td>
<td>-631.5</td>
<td>-2893.9</td>
<td>-631.5</td>
<td>-550.9</td>
<td>-1040.7</td>
<td></td>
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<tr>
<td>Net Financial Results/ GDP %</td>
<td>-0.20</td>
<td>-0.87</td>
<td>-3.35</td>
<td>0.30</td>
<td>-1.18</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net Financial Results/Govt. Expenditures $Million</td>
<td>-1.8</td>
<td>-7.9</td>
<td>-31.4</td>
<td>-3.8</td>
<td>-11.2</td>
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<tr>
<td>Payments to Govt. (Gross Taxes, Transfers &amp; Dividends) $Million</td>
<td>171</td>
<td>206</td>
<td>182</td>
<td>971</td>
<td>549</td>
<td>492</td>
<td>410.1</td>
<td></td>
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<tr>
<td>Payments to Govt./ Govt. Revenue %</td>
<td>5.8</td>
<td>6.3</td>
<td>3.5</td>
<td>9.5</td>
<td>1.3</td>
<td>1.4</td>
<td>0.6</td>
<td>4.0</td>
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</tr>
<tr>
<td>Current subsidies to SOEs (Operating Subsidies) $Million</td>
<td>372</td>
<td>619</td>
<td>729</td>
<td>1129</td>
<td>438</td>
<td>852</td>
<td>958</td>
<td>728.1</td>
<td></td>
</tr>
<tr>
<td>Current subsidies / Govt. Current Expenditure %</td>
<td>8.90</td>
<td>9.78</td>
<td>8.47</td>
<td>8.42</td>
<td>1.88</td>
<td>2.22</td>
<td>1.57</td>
<td>5.89</td>
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4.5 THE ECONOMIC RECOVERY PROGRAMME (ERP)

Background to Economic Recovery.

It is worth noting here that the problems of the State Owned Enterprises noted above were not unique to the SOEs but to the economy as a whole. The woes of the public sector may rather be seen as a reflection of the sickening condition of the economy at large; a condition that began in the 1960s but became very critical in the 1980-1983 period. The economy of Ghana, between 1960 and 1980 was characterised, in varying degrees by high inflation, fiscal imbalances, declining growth and political instability. The country was in a state of absolute poverty as a result of a gradual decline in per capita income, accompanied by a worsening income distribution, and growing unemployment. Aid donors gradually withdrew their support, having been discouraged by the deterioration in the economy, political instability, and poor policy performance, and thus worsening further, the already bad balance of payment situation.

The early 1980s saw the economy of Ghana at its worse, with a sharp decline in real GDP and real GDP per capita, severe shortages of food and foreign exchange, galloping inflation, a booming black market (commodities as well as foreign exchange), and a grossly imbalanced fiscal account. (See table 4.12 below). It is estimated that between 1970 and 1982 GDP declined by 0.5 per cent each year, and real income per capita in 1982 was estimated to be 75 per cent of its 1970 level.
Table 4.12: Ghana: Selected Economic Indicators Before the ERP

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<tr>
<td>(Percentage Changes)</td>
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<td></td>
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<tr>
<td>Real GDP</td>
<td>6.8</td>
<td>-12.9</td>
<td>2.3</td>
<td>8.5</td>
<td>-3.2</td>
<td>0.6</td>
<td>-2.9</td>
<td>-6.5</td>
</tr>
<tr>
<td>Real GDP per Capita</td>
<td>4.6</td>
<td>-15.0</td>
<td>1.3</td>
<td>5.0</td>
<td>-5.1</td>
<td>-3.9</td>
<td>-4.2</td>
<td>-10.3</td>
</tr>
<tr>
<td>Consumer Price Index</td>
<td>3.0</td>
<td>29.8</td>
<td>116.5</td>
<td>73.7</td>
<td>53.9</td>
<td>50.1</td>
<td>116.5</td>
<td>22.3</td>
</tr>
<tr>
<td>(As Percentage of GDP)</td>
<td></td>
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<td></td>
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<td></td>
</tr>
<tr>
<td>Gross Domestic Investment</td>
<td>14.2</td>
<td>12.7</td>
<td>11.1</td>
<td>5.4</td>
<td>6.5</td>
<td>5.6</td>
<td>4.6</td>
<td>3.4</td>
</tr>
<tr>
<td>Gross Domestic Savings</td>
<td>12.8</td>
<td>13.7</td>
<td>10.0</td>
<td>4.0</td>
<td>6.6</td>
<td>4.9</td>
<td>4.0</td>
<td>3.7</td>
</tr>
<tr>
<td>Government Revenue and Grants</td>
<td>19.3</td>
<td>15.4</td>
<td>10.5</td>
<td>6.6</td>
<td>9.2</td>
<td>6.7</td>
<td>4.5</td>
<td>5.3</td>
</tr>
<tr>
<td>Government Expenditure and Net Lending</td>
<td>21.6</td>
<td>22.9</td>
<td>20.0</td>
<td>15.7</td>
<td>15.6</td>
<td>11.1</td>
<td>11.0</td>
<td>11.2</td>
</tr>
<tr>
<td>Government Budget Balance</td>
<td>-2.3</td>
<td>-7.6</td>
<td>-9.5</td>
<td>-9.1</td>
<td>-6.4</td>
<td>-4.4</td>
<td>-6.5</td>
<td>-5.9</td>
</tr>
<tr>
<td>(Million US Dollars)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Current Account</td>
<td>-67.7</td>
<td>17.6</td>
<td>-79.7</td>
<td>-45.9</td>
<td>122</td>
<td>29.2</td>
<td>-420.8</td>
<td>-108.6</td>
</tr>
<tr>
<td>Exports, FOB</td>
<td>427.0</td>
<td>801.0</td>
<td>889.6</td>
<td>892.8</td>
<td>1065.7</td>
<td>1103.6</td>
<td>710.7</td>
<td>607.0</td>
</tr>
<tr>
<td>Imports, FOB</td>
<td>375.1</td>
<td>650.5</td>
<td>860.2</td>
<td>780.3</td>
<td>803.1</td>
<td>908.3</td>
<td>954.3</td>
<td>588.7</td>
</tr>
<tr>
<td>Direct Investment</td>
<td>67.8</td>
<td>70.9</td>
<td>19.2</td>
<td>9.7</td>
<td>-2.8</td>
<td>15.6</td>
<td>16.3</td>
<td>16.3</td>
</tr>
<tr>
<td>Changes in Reserves</td>
<td>6.6</td>
<td>2.5</td>
<td>-109.4</td>
<td>-85.5</td>
<td>31.0</td>
<td>95.7</td>
<td>35.9</td>
<td>1.3</td>
</tr>
<tr>
<td>External Debt</td>
<td>548.7</td>
<td>729.3</td>
<td>1058.4</td>
<td>1269.0</td>
<td>1272.5</td>
<td>1314.4</td>
<td>1461.8</td>
<td>1397.0</td>
</tr>
<tr>
<td>(Percentages)</td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net capital inflow</td>
<td>2.8</td>
<td>-0.4</td>
<td>0.6</td>
<td>0.7</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
<td></td>
</tr>
<tr>
<td>External Debt/ GDP</td>
<td>24.8</td>
<td>15.9</td>
<td>11.8</td>
<td>10.7</td>
<td>13.8</td>
<td>9.1</td>
<td>6.5</td>
<td></td>
</tr>
<tr>
<td>Debt Service Ratio</td>
<td>5.0</td>
<td>3.2</td>
<td>3.6</td>
<td>6.5</td>
<td>6.0</td>
<td>7.7</td>
<td>6.6</td>
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</table>

Production in most sectors of the economy fell sharply due to a weakening of incentives. The production and export earnings of the main export crop, cocoa dropped drastically, which, coupled with increasing dissatisfaction with the performance of the economy by aid donors, greatly reduced the country's capacity to import. Poor fiscal management, compounded by the erosion in the resource base, generated large budgetary deficits that fuelled inflation. The country's infrastructure suffered severe neglect causing a marked deterioration in the volume and quality of economic and social services. More significantly, the notable negative trend in the Ghanaian economy put a severe strain on the human infrastructure with over two million Ghanaians (including professionals) leaving the country in search of greener pastures. This resulted in shortages of trained manpower and also contributed to a contraction in the acreage under cultivation in the labour-intensive agricultural sector. The domestic problems aside, the country's external terms of trade sharply deteriorated following the increase in petroleum prices and the falling in prices of Ghana's major exports (Cocoa and Gold).

The cumulative effect of the downward economic spiral largely reflected in the trends in key economic indicators between 1970 and 1982 (as shown in table 4.12 above). For example, per capita real income fell by 30 per cent, import volumes fell by a third, real export earnings dropped by 52 per cent, domestic savings and investment declined from 12 per cent and 14 per cent of GDP respectively in 1970 to almost insignificant levels and inflation averaged 44 per cent per annum over the period. The situation was aggravated by the return of over one million Ghanaians (who had been
deported from Nigeria) in 1982 putting further strain on an already tottering economy. It was against this economically depressing background that the PNDC Government launched its Economic Recovery Programme (ERP) in 1983.

**The Economic Recovery programme (ERP)**

The Economic Recovery Programme was carried in two main phases:

1) ERP I (1983 – 1986) and


The first phase of the ERP was set within a 4 – year time frame. The first year, 1983 – 1984 was devoted to stabilisation and the preparation of the economic conditions for the launching of a medium term programme, 1984 – 1986. The objective of the stabilisation period (1983 –1984) was to re-align relative prices in favour of production and exports, reduce government budget deficits and its underlying pressures and to facilitate the flow of imports to ease the severity of shortages in the economy. The medium – term programme (1984 – 1986) focussed mainly on rehabilitation, liberalisation, and growth of the economy. It was aimed at introducing macroeconomic adjustments, which were needed to support other measures designed to rehabilitate the physical infrastructure and remove bottlenecks that inhibited supply response.

The second phase of the ERP was aimed at strengthening and building upon the foundation laid by the ERP I. Policy actions undertaken during the second phase were largely in the context of the longer - term aims of the
ERP. It was aimed at the creation of a growth-oriented, competitive, efficient and integrated economy in which the living standard of the average Ghanaian would be progressively raised. See GOG, October (1985); Kusi (1991). The main focus of ERP II was to implement a structural adjustment programme (SAP), at the core of which was a 3-year rolling public investment programme (PIP). It should be noted however that, the key elements of the ERP II were on the whole very similar to those of the ERP I, and that the sequencing of the phases of the reform process was in practice not distinct but substantially overlapped. The two phases may therefore be considered as parts of a continuous, rather than separate segments of the programme. The key policy measures of the recovery programme include:

a) Exchange and Trade Policy Reform,
b) Fiscal policy,
c) Public Sector Management Reforms,
d) State-Owned Enterprises Reforms and Divestiture,
e) Monetary Policy
f) Cocoa Sector Policy
g) Encouraging the Private Sector
h) Programme to Mitigate the Social Cost of Adjustment (PAMSCAD)
i) External Debt policy
j) Financial Institutions Sector Adjustment programme (FINSAP)

a) Exchange and Trade Policy Reform

The value of the local currency (The Cedi (¢)) has been of much concern to policy makers over the years. The cedi had been consistently over
valued and thus becoming the principal cause of the country's low international competitiveness and disincentive to production and exports. The reforms were therefore aimed at promoting efficiency in production, tapping economic rent, and directing foreign remittances through official channels. A transitional measure saw the introduction of a multiple exchange rate which imposed surcharges on foreign exchange payments and bonuses on foreign exchange receipts, and which effectively resulted in two exchange rates, introduced in April 1983: \( \varepsilon \)23,375 = US$1.00 and \( \varepsilon \)29.975 = US$1.00. These two rates were subsequently unified in October 1983, resulting in a single exchange rate of \( \varepsilon \)30 = US$1.00. The significant feature of this rate was that it was periodically adjusted to maintain its real purchasing power in terms of the currencies of the country's major trading partners. In September 1986, a two-window system was introduced that sought to move the exchange rate rapidly towards its equilibrium. Under this system, the window I rate was administratively determined, and took care of proceeds from exports of cocoa and residual oil, payments for petroleum products, pharmaceuticals and official debt service payments. Window II on the other hand was determined by a weekly foreign exchange auction, and took care of all other transactions.

Again in February 1987, the two-window system was unified, with the introduction of the Dutch Auction System. Under this system, the quoted exchange rate was set at a marginal rate necessary to exhaust the available foreign exchange, and successful bidders were required to pay
the rate they bid. In addition, all bidders were required to deposit 100% of the cedi value of the foreign exchange successfully bid. Following the introduction of the auction in 1986, the cedi has consistently depreciated reaching an average of ₴270 = US$1.00 in 1989.

Policy measures taken, in line with reform, to improve the exchange system include:


b. Export retention scheme (set at 20 – 35% depending the type of commodity)

c. Liberalisation (end of price controls, ceilings on agricultural purchase prices with the exception of cocoa, shea nuts and palm oil, and abolition of import licenses) was introduced.

b) Fiscal Policy

Among the key elements of the adjustment efforts were the restoration of fiscal discipline and the pursuit of a growth oriented fiscal strategy. The main thrust of the fiscal policy was the reduction of fiscal deficits with policy measures that reflected the impact of the new exchange rate adjustments. It also involved attempts to restore the tax base, which had been greatly eroded by the persistent overvaluation of the cedi and the large divergence between the official (the base at which taxes are assessed) and market prices (at which market transactions take place).
On the revenue side, measures were taken to make revenue more responsive to changes in the economy. The basis for tax assessment for import duties, sales and purchases tax was revised to make the value of dutiable goods reflect the face value plus some surcharges. Also, the basis for tax assessment of corporate income was changed from profits of the previous years to actual income earned for the current year. Further, the practice of advance payment of taxes at the beginning of each quarter, which caused extensive tax evasion, was changed so that corporate bodies and self-employed could rather pay their taxes at the end of the quarter. There were some reforms also in the area of personal income tax. Here, the policy was directed at adjusting the tax brackets and to a lesser extent the tax rates. In addition there was a general increase in all taxes supported by an upward revision of fees and levies for various services provided by government institutions.

Measures taken on the expenditure side included strict scrutiny of selected expenditure items, removal of fictitious (ghost names) from the government payroll and the introduction of the policy that sought to keep the total wages bill in the budget at 5 – 6 per cent of GDP. A redeployment exercise was introduced that aimed at reducing the workforce of the civil service. In all, some 5 per cent of the personnel (about 15,000 workers) were earmarked for redeployment each year, between 1988 – 1990. Efforts were also directed at raising capital outlays in the context of a rationalised three-year rolling public investment programme. This programme was aimed at enhancing growth by
rehabilitating economic infrastructure by channelling more resources to operations and services, particularly in priority sectors of agriculture, health and education.

c) Public Sector Management Reforms
The primary aim of the public sector management reforms was to overcome the inefficiencies and weaknesses and by that strengthen public sector management capabilities. Measures taken included the provision of financial resources for training, equipment and materials to strengthen the analytical capabilities of key economic and financial management agencies, attract and retain skilled Ghanaians into the public service, promote civil service reform and assist in the implementation of the civil service redeployment programme. In line with this objective, a government task force (supported technically by a team of ODA consultants) was set up to review the civil service wages and salary structure. The result was a substantial revision of salaries in 1988. Further, a “Skills Mobilisation Scheme” was launched, which provided for expatriate Ghanaians returning home to join the public service as well as special financial rewards to civil and public servants who were given specific SAP-related jobs. Also, the 5 per cent civil service redeployment policy was linked to the public sector management reforms.

d) State-Owned Enterprise Reforms and Divestiture
The SOEs reform programme was directed at improving efficiency and productivity, reducing the financial and management burden of the
enterprises on the government, and increasing their managerial autonomy and accountability. The key elements of the programme include:

a. Formulation of an appropriate policy framework (including policy of products and services; access to current and capital budgetary transfers) for the SOEs sector.

b. Divestiture or privatisation programme

c. Strengthening SOE management and government's ability to monitor and evaluate their managerial performance.

e) Monetary Policy

With the start of the reform programme in 1983, a broadly restrictive credit policy was pursued, aimed at holding domestic credit expansion below 20 per cent (largely by reducing government borrowing). Subsequently, strict limits were placed on domestic bank lending, in addition to the provision of credit guidelines to the commercial banks by the central bank. In order to strengthen the incentives for financial savings and to restore confidence in the banking system, a more liberalised interest rate policy was put in place. By 1988 however, most of the controls on interest rates and sectoral distribution of bank credit had been removed (with the particular exception of the minimum credit requirement of the agriculture sector).

f) Cocoa sector policy

Under the ERP, special priority was accorded to the export-oriented sectors of the economy, notably, cocoa, timber, and mining. The
recovery of the cocoa industry was considered a vital element not only because of the importance of the industry in export revenue (and for that matter government revenue and agricultural employment) but also because of the punitive levels of implicit taxation embodied in pre-ERP producer prices. The immediate action plan was directed at the arrest and reversal of the decline in cocoa production. Small-scale cocoa farmers were encouraged to rehabilitate and re-cultivate their farms through remunerative producer prices. This saw the upward adjustment and revision of producer prices reaching up to ₡170,000 per ton in 1988 as against ₡20,000 per ton in 1983. The result of these major price adjustments (made possible by the exchange rate depreciation) was that, the cocoa producer price as a proportion of world market price increased to 41.1 per cent in 1988 from the 1984 low of 30.3 per cent, with a target mark of 55 per cent by 1989. Further efforts were directed towards the acquisition and distribution of inputs (spraying machines and insecticides etc) to farmers. A special re-planting programme was also launched in areas most affected by bush fires and swollen shoot disease. At the same time, a major restructuring of the Ghana Cocoa marketing Board was initiated with the aim of improving the boards efficiency and reducing operational costs so as to allow farmers to receive incentive prices and to achieve set targets.

**g) Private sector Development**

The ERP also saw much effort made to actively attract and encourage both domestic and foreign investment, particularly in the areas of
petroleum exploration and production, mining and mineral processing, timber logging, wood processing and domestic resource-based manufacturing activities. In all, the private sector was expected to account for about 70 per cent of the costs of rehabilitation, by playing a substantial role in the rehabilitation programme. It should be noted that, part of the motivation for reducing the size of the public sector and the prevalence of state controls was to encourage the growth of private investment. Thus provision was made for the private sector to be consulted in a tripartite government-employers-workers forum under the National Economic Commission. Further incentives given to the private sector include the reduction of company income tax in the manufacturing sector from 50 per cent in 1983 to 45 per cent in 1985. The introduction of the Ghana Investment Code in July 1985 and a new minerals Code in 1986 stand as the most significant measures adopted to attract and encourage private sector investment.

The key features of the investment code include the listing of some priority areas of government concern to which large benefits were accorded. Areas like agriculture, industry, tourism, and real estate development were exempted from paying duties on imported plant, equipment and accessories, and further enjoyed attractive depreciation and investment allowances and income tax rebates. They were further permitted to maintain offshore accounts in which 25 per cent of foreign exchange earnings may be retained for the importation of equipment and inputs and for the payment of dividends and remittances abroad. The
code also offered government guarantees against expropriation and provided for arbitration in case of investment disputes. See Ghana Investment Code, 1985 pp. 4 - 5; and also the Government of Ghana (GOG) Minerals Commission law, 1986.

h) Programme of Action to Mitigate the Social Cost of Adjustment (PAMSCAD)

Alongside the reforms, government efforts were also directed at helping alleviate the suffering of vulnerable groups in society most affected by the social costs of the adjustment process. Among them were people who have had to lose their jobs as a result of redeployment exercises, as well as the rural population, and some lower income urban dwellers, who were not likely to share in the benefits of the recovery programme in the short term. The government was concerned about the fact that, the sustainability of the recovery programme could be endangered if attention was not paid to its social dimensions. To this end, in 1988, the government considered as an integral component of the SAP, an action programme, aimed at improving the delivery of basic services to the poor, raising their productivity, and further enhancing their opportunities for gainful employment. The PAMSCAD included 24 specific projects grouped under 5 main categories as:

I. Community initiative projects
II. Employment generation projects
III. Projects for the redeployed
IV. Basic needs projects

V. Education projects

Employment generation projects constituted the largest component of PAMSCAD, accounting for US $35.13 million, representing 41.7 per cent of total programme costs. The redeployment programme (i.e. the retrenchment of employees of the civil service and the SOEs as part of the ERP) was expected to worsen the unemployment situation in the country; hence the PAMSCAD initiative sought to the creation of about 40,000 new jobs in 1988 and 1989, through various community-based activities.

i) External Debt Policy

Another important element of the reform package was the gradual reduction in the size of the country's external debts. The policy was primarily aimed at improving the confidence of the international trading and finance community in the country. Outstanding debt payments (amortization, interest payments, short-term capital payment arrears) were estimated at US$864 million between the period 1983 – 1985. This figure was to increase to US$871 million between 1986 – 1988. This gives an annual average payment of US$289 million between 1983 and 1988, and planned debt service ratio (excluding arrears reduction) to increase from 43 per cent in 1983 to 57 per cent in 1988. The sheer size of these debt payments called for a prudent external debt management policy, which focused on alleviating the debt service burden by seeking official external assistance in the form of grants or high concessional long-
term loans. Public borrowing from non-concessional sources was strictly restricted and the inflow of private direct investment became a crucial element of the reform process.

j) Financial Institutions Sector Adjustment Programme (FINSAP)

It became obvious that the structural adjustment programme may not achieve much success without an efficient financial sector to mobilise resources for investment in the private sector. To this end, the country embarked on financial sector reforms as part of the structural adjustment programme (FINSAP), with the assistance of the World Bank, the IMF and other donor agencies. The programme, launched in 1988 had the following as its main objectives:

i. to deregulate interest rates and remove ceilings on lending rates;
ii. to privatise state-owned financial institutions and commercial banks;
iii. to enhance the soundness of the banking institutions by improving prudential regulation and supervision by the Bank of Ghana (BOG);
iv. to improve deposit mobilization and efficiency of credit allocation;
and
v. to develop the money and securities markets.

In line with these objectives, various banks and non-banking financial institutions were licensed during the post-reform period, the most notable achievement being the opening of the Ghana Stock Exchange in November 1990.
Results of Economic Reforms

In very broad terms, the main objectives of the economic stabilisation and growth were achieved. The economy registered growth for six consecutive years since 1984 (as shown by the main economic indicators in table 4.13 below). Average annual real GDP growth of 6.0 per cent was registered for the period 1984 – 1989, whilst Gross Domestic Investment to GDP ratio increased from under 4 per cent in 1983 to 15 per cent in 1989, and real GDP per capita growth averaged 2.4 per cent for the same period.

This remarkable growth in GDP also reflected in all sectors of the economy with the industrial sector showing the strongest supply response to the economic reform measures. Manufacturing output increased on the average by 9.2 per cent annually, mining by 7.1 per cent and agriculture by 2.2 per cent in for the same period 1984 –1989. Domestic inflation rates, though still very high declined considerably, falling from 122.8 per cent in 1983 to 25.2 per cent in 1989, mainly as a result of the strong improvement in the GDP growth and the liberalisation of trade, which had permitted large imports of goods into the country.

Remarkable success was also achieved in reversing the growing fiscal deficits that characterised the pre-reform period. From an annual average deficit of 2.2 per cent in 1983 – 1985, government fiscal balance as a percentage of GDP improved to a surplus of 0.5 per cent in 1986 – 1989. This was largely a result of the extensive tax reforms and the rationalisation of government expenditure. The tax reforms did not only
lead to improvements in the tax bases and effective enforcement of tax laws, but also widened the tax net and substantially reduced evasion, leading to substantial tax collection.

The reform also recorded remarkable increases in exports from both the traditional and non-traditional commodities. However, total export earnings continued to lag behind import costs and thus leaving a deficit in the current account each year 1983–1989. Merchandise exports increased steadily from US$439.1 million in 1983 to US$807.2 million in 1989, whilst imports increased rather sharply from US$499.7 million to US$1034.8 million over the same period. Trade volumes also improved considerably. Exports grew at an annual average of 5.3 per cent whilst import growth recorded an average of 9.8 per cent in 1983 – 1989. The shortfall in trade balance was compounded by the ever-increasing net income deficit, which has shown no sign of decline since 1970. However, as a result of the trade and exchange reforms, supported by the strong fiscal discipline, the country has been able to virtually eliminate all external payments arrears, whilst at the same time improving the international reserves position. See Green, 1988, 1987, 1986; Jonah, 1989; Toye, 1990; Weissman, 1990; Young, 1989; Morna, 1988; Hodges, 1988; Ewusi, 1987; Government of Ghana (GOG), 1989, 1986, 1985, 1982, 1977; World Bank, 1991, 1987, 1984, 1981
Table 4.13: Ghana: Selected Economic Indicators (Post-ERP)

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<tr>
<td>(Percentage Changes)</td>
<td></td>
<td></td>
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<tr>
<td>Gross Domestic product (1975 prices)</td>
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<td>8.6</td>
<td>5.1</td>
<td>5.2</td>
<td>4.8</td>
<td>6.2</td>
<td>6.1</td>
</tr>
<tr>
<td>Gross Domestic Product per capita</td>
<td>-7.5</td>
<td>5.8</td>
<td>2.4</td>
<td>2.5</td>
<td>2.1</td>
<td>3.5</td>
<td>3.4</td>
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<tr>
<td>Consumer Price Index (CPI)</td>
<td>122.8</td>
<td>39.7</td>
<td>10.4</td>
<td>24.6</td>
<td>39.8</td>
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<td>25.2</td>
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<tr>
<td>Agricultural Production</td>
<td>-7.0</td>
<td>9.7</td>
<td>0.7</td>
<td>3.3</td>
<td>0.0</td>
<td>3.6</td>
<td>4.9</td>
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<tr>
<td>Total Industrial Output</td>
<td>-22.9</td>
<td>8.7</td>
<td>17.6</td>
<td>7.6</td>
<td>11.5</td>
<td>11.4</td>
<td>7.4</td>
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<tr>
<td>Manufacturing sector</td>
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<td>13.7</td>
<td>24.3</td>
<td>11.0</td>
<td>10.0</td>
<td>9.2</td>
<td>8.0</td>
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<tr>
<td>Services Sector</td>
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<td>6.9</td>
<td>7.5</td>
<td>6.6</td>
<td>9.4</td>
<td>7.9</td>
<td>7.0</td>
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<tr>
<td>Export Volumes</td>
<td>-27.9</td>
<td>2.0</td>
<td>21.1</td>
<td>10.8</td>
<td>7.7</td>
<td>12.3</td>
<td>11.3</td>
</tr>
<tr>
<td>Import Volumes</td>
<td>-9.7</td>
<td>27.0</td>
<td>11.2</td>
<td>14.3</td>
<td>12.9</td>
<td>10.2</td>
<td>3.0</td>
</tr>
<tr>
<td>(As Percentage of GDP)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Gross Domestic Investment</td>
<td>3.7</td>
<td>7.0</td>
<td>9.6</td>
<td>9.6</td>
<td>13.3</td>
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<td>Gross Domestic Savings</td>
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<td>7.6</td>
<td>7.9</td>
<td>11.1</td>
<td>13.8</td>
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<td>Government Budget Balance¹</td>
<td>-2.7</td>
<td>-1.8</td>
<td>-2.2</td>
<td>0.1</td>
<td>0.5</td>
<td>0.4</td>
<td>0.8</td>
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<td>Current Account Balance²</td>
<td>-6.1</td>
<td>-4.1</td>
<td>-5.4</td>
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<td>-4.3</td>
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<td>-5.9</td>
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<td>Net Capital Inflow</td>
<td>0.2</td>
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<td>1.4</td>
<td>1.1</td>
<td>5.1</td>
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<td>4.9</td>
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<td>External Debt</td>
<td>3.6</td>
<td>23.7</td>
<td>34.0</td>
<td>42.6</td>
<td>61.8</td>
<td>58.6</td>
<td>58.5</td>
</tr>
<tr>
<td>(Million US Dollars)</td>
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<tr>
<td>Current Account Balance</td>
<td>-248.3</td>
<td>-180.0</td>
<td>-243.7</td>
<td>-165.5</td>
<td>-220.1</td>
<td>-261.9</td>
<td>-310.6</td>
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<tr>
<td>Exports: FOB</td>
<td>439.1</td>
<td>566.7</td>
<td>632.3</td>
<td>749.4</td>
<td>824.0</td>
<td>881.0</td>
<td>807.2</td>
</tr>
<tr>
<td>Of which Cocoa</td>
<td>268.6</td>
<td>381.7</td>
<td>412.0</td>
<td>503.3</td>
<td>495.4</td>
<td>462.0</td>
<td>407.8</td>
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<tr>
<td>Imports: FOB</td>
<td>-499.7</td>
<td>-616.0</td>
<td>-671.3</td>
<td>-733.5</td>
<td>-933.8</td>
<td>-990.9</td>
<td>-1034.8</td>
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<td>Foreign direct Investment</td>
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<td>2.0</td>
<td>5.6</td>
<td>4.3</td>
<td>4.7</td>
<td>5.0</td>
<td>15.0</td>
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<td>Foreign reserves¹</td>
<td>144.8</td>
<td>301.6</td>
<td>478.4</td>
<td>513.0</td>
<td>195.1</td>
<td>221.3</td>
<td>347.3</td>
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<td>External Debt</td>
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<td>1897.7</td>
<td>2174.3</td>
<td>2652.1</td>
<td>3133.8</td>
<td>3112.6</td>
<td>3077.7</td>
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<tr>
<td>Debt Service Payments</td>
<td>146</td>
<td>143</td>
<td>162</td>
<td>233</td>
<td>422</td>
<td>538</td>
<td>438</td>
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Central Bureau of Statistics, Quarterly Digest of Statistics, June 1989; March 1990

¹ Excluding capital expenditure financed through external project aid
² Before official transfers
³ Excluding Gold holdings.
Table 4.14: Ghana: Selected Economic and Financial Indicators (Current)

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<td>National income and prices</td>
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<tr>
<td>Real GDP</td>
<td>4.6</td>
<td>4.2</td>
<td>5.6</td>
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<td>5.5</td>
<td>6.0</td>
</tr>
<tr>
<td>Real GDP per capita</td>
<td>1.8</td>
<td>1.5</td>
<td>2.8</td>
<td>1.8</td>
<td>2.7</td>
<td>3.2</td>
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<tr>
<td>Nominal GDP</td>
<td>46.3</td>
<td>24.5</td>
<td>25.1</td>
<td>14.6</td>
<td>13.7</td>
<td>12.2</td>
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<tr>
<td>GDP deflator</td>
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<td>19.5</td>
<td>20.6</td>
<td>17.6</td>
<td>8.6</td>
<td>7.4</td>
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<tr>
<td>Consumer price index (annual average)</td>
<td>46.6</td>
<td>27.9</td>
<td>15.5</td>
<td>19.3</td>
<td>10.0</td>
<td>6.4</td>
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<tr>
<td>Consumer price index (end of period)</td>
<td>32.7</td>
<td>20.8</td>
<td>11.0</td>
<td>15.8</td>
<td>9.0</td>
<td>5.0</td>
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<tr>
<td>Investment and saving</td>
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<tr>
<td>Gross investment</td>
<td>21.5</td>
<td>24.1</td>
<td>17.9</td>
<td>22.9</td>
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<td>Private</td>
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<td>5.5</td>
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<td>12.6</td>
<td>13.4</td>
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<tr>
<td>Public</td>
<td>13.3</td>
<td>12.4</td>
<td>12.4</td>
<td>11.1</td>
<td>11.1</td>
<td>11.3</td>
</tr>
<tr>
<td>Gross national saving</td>
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<td>15.4</td>
<td>13.7</td>
<td>19.4</td>
<td>20.8</td>
<td>22.2</td>
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<tr>
<td>Private</td>
<td>13.7</td>
<td>15.0</td>
<td>8.3</td>
<td>16.2</td>
<td>15.2</td>
<td>15.5</td>
</tr>
<tr>
<td>Public</td>
<td>3.0</td>
<td>0.4</td>
<td>5.4</td>
<td>3.2</td>
<td>5.6</td>
<td>6.6</td>
</tr>
<tr>
<td>Government budget</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Domestic revenue</td>
<td>17.6</td>
<td>17.3</td>
<td>18.3</td>
<td>18.3</td>
<td>18.8</td>
<td>18.9</td>
</tr>
<tr>
<td>Total grants</td>
<td>2.6</td>
<td>1.4</td>
<td>2.9</td>
<td>2.9</td>
<td>2.4</td>
<td>2.0</td>
</tr>
<tr>
<td>Total expenditure /1</td>
<td>29.7</td>
<td>28.6</td>
<td>27.5</td>
<td>28.6</td>
<td>26.8</td>
<td>25.6</td>
</tr>
<tr>
<td>Overall balance (commitment basis)</td>
<td>-9.5</td>
<td>-9.9</td>
<td>-6.3</td>
<td>-8.1</td>
<td>-5.5</td>
<td>-4.7</td>
</tr>
<tr>
<td>Domestic primary balance</td>
<td>0.3</td>
<td>3.2</td>
<td>3.8</td>
<td>3.6</td>
<td>3.5</td>
<td>3.6</td>
</tr>
<tr>
<td>Divestiture receipts</td>
<td>1.3</td>
<td>0.7</td>
<td>0.9</td>
<td>0.8</td>
<td>0.5</td>
<td>0.4</td>
</tr>
<tr>
<td>External sector</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current account balance /2</td>
<td>-4.7</td>
<td>-8.8</td>
<td>-4.2</td>
<td>-3.5</td>
<td>-2.9</td>
<td>-2.5</td>
</tr>
<tr>
<td>External debt outstanding</td>
<td>84.2</td>
<td>83.5</td>
<td>95.2</td>
<td>79.2</td>
<td>76.9</td>
<td>74.6</td>
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<tr>
<td>External debt service, including to the IMF</td>
<td>8.9</td>
<td>7.6</td>
<td>8.7</td>
<td>7.5</td>
<td>6.2</td>
<td>6.7</td>
</tr>
<tr>
<td>(in percent of exports of goods and nonfactor services)</td>
<td>35.7</td>
<td>31.6</td>
<td>33.2</td>
<td>28.1</td>
<td>24.5</td>
<td>24.7</td>
</tr>
<tr>
<td>(in percent of government revenue)</td>
<td>38.7</td>
<td>44.9</td>
<td>38.1</td>
<td>34.7</td>
<td>29.8</td>
<td>26.2</td>
</tr>
</tbody>
</table>

Sources: Ghanaian authorities; and IMF staff estimates and projections.

1/ Including capital outlays financed through external project aid and transfers to the local authorities.
2/ From December 1996, the coverage was increased from 11 to 17 banks.
4.3 SUMMARY

In this chapter we have tried to explore the growth and development of the public sector of Ghana. We examined the contributions of various governments since independence to the increase in the number of state-owned enterprises over the years. The reasons for setting up these SOEs, their contribution to the economy and their overall performance over the years was discussed, giving a vivid picture of the state of these SOEs before the Economic Recovery Programme.

The Economic Recovery Programme was given some attention here because of its special implications for the privatisation programme. In the first place, the privatisation programme came as an integral component of the recovery programme. Again as we have noted earlier in this study, the ERP/SAP injected a lot of changes into the economy including some observable discipline into the public sector even before the start of the privatisation process. The ERP/SAP further provided the appropriate environment for private sector participation in economic activity. The discussion on the ERP is also important because of the effects of structural changes on the performance of privatised firms. The argument has been that, given this new and improved environment, most SOEs may produce similar results as the privatised firms.

We therefore turn our attention now to the privatisation programme itself. Chapter 5 will take us through Ghana’s Divestiture Programme; the earlier
attempts, the new process, and the results achieved so far. It is the concluding chapter of this study.
CHAPTER 5

PRIVATISATION IN GHANA

5.1 INTRODUCTION

The previous chapter gave us background knowledge to the growth of the public sector and the state of public enterprises as at the beginning of the economic reform process. The poor performance of the SOEs was vividly captured. The economic transformation process (ERP/SAP) and the resultant positive effects on the economy at large were also discussed. Among others, we saw public sector management reforms and divestiture of state owned enterprises as important components of the ERP/SAP, in line with the need to reduce the size of the public sector and to improve the performance of SOEs by mobilising private sector management and capital.

In this chapter, we finally bring our focus down to the privatisation programme in Ghana. Our discussion will take us from the earlier attempts at privatisation, through to the current programme. We shall examine the reasons for divestiture, the legal framework, the methods of divestiture and the basic procedure employed. Some of the key SOEs divested shall be examined in the light of the objectives for their divestiture. The overall achievements and some obvious obstacles to the programme shall also be discussed with a view to identifying some possible policy suggestions for the future.
5.2 EARLIER ATTEMPTS AT PRIVATISATION

The first recorded attempt at privatisation in Ghana dates back to the late 1960s (1966-1969) after the overthrow of the CPP government of Dr. Kwame Nkrumah. The military government of the NLC as we noted in chapter 4, adopted a reactionary stance in rejecting close to everything that Nkrumah had sought to do, and tried to reverse most of his mainly socialist economic policies. The NLC government sought to disengage the state from direct participation and control, and instead tried to regulate the economy indirectly through the medium of the market. In pursuit of this new policy direction, the NLC government decided to divest the state from the burden of financing and managing the numerous SOEs created by the former government and to place them under the supervision of the Industrial development Corporation (IDC) and the Agricultural Development Corporation (ADC).

In this first attempt at divestiture, two options were adopted: a) outright sale, and b) private participation in the form of joint ventures. Out of the 53 state-owned enterprises at the time, 20 were earmarked for divestiture (put on the 'sell' list). 7 out of the 20 were listed for sale and 13 others marked for joint-ventureships. As noted earlier, the programme could not be fully implemented however, as only 4 minor firms were actually sold. The enterprises sold included the State Furniture and Joinery Corporation, the State Bakery Corporation, the State Laundries Corporation, and the State Tyre Re-treading Corporation. Three others; Bonsaso Rubber/Tyre Factory,
the State Match Factory, and the Tema Cement Works (now Ghacem Ltd) became joint venture firms with foreign private participation.

The programme, on the whole, became very controversial and unsuccessful, as issues involved were not clearly analysed and/or co-ordinated from the onset. The major setback was the public outcry and vehement reaction against the sale of the State Pharmaceutical Factory to a private firm known as Abbot Laboratories Ltd. The withdrawal of the sale offer to Abbot Laboratories closed the chapter to Ghana's first efforts at privatisation, leaving no significant impact on the economy. Nevertheless, the attempt per se did place Ghana on the map as one of the few countries (world wide) to have embarked on a privatisation drive, long before it became a universally accepted policy for economic growth and development.

5.3 REASONS FOR PRIVATISATION

The abysmal performance of state-owned enterprises and their continuous drain on state coffers was noted in the previous chapter, and the need for some form of change in the fortunes of these enterprises became increasingly obvious. The government in a policy statement on SOEs summed its motives for divestiture thus:

Given the generally negative performance of Ghana's SOEs, a re-examination of the extent of state involvement in enterprises is not only urgent but also unavoidable. Many enterprises that are potentially viable are on the verge of bankruptcy through mismanagement of the originally invested resources and the government alone is not able to undertake the massive capitalisation needed by most of them. As a result, the government had acknowledged the necessity of reappraising the management and ownership structure of the enterprises. (See Adda, 1989, p.311)
Factors that had contributed to the disappointing performance of the SOEs, as noted by the Divestiture Implementation Committee (2000), include:

a. Over staffing

b. Decision making at times being paralysed by excessive bureaucracy and a laissez-faire attitude towards state business.

c. The lack of technical expertise

d. The absence of the commitment and entrepreneurial direction that private investors bring to business.

e. Low incentives for management and inadequate working capital and investment in new plant and machinery

Government's primary objective for privatisation has been to reverse the above negative trends. In other words, divestiture was embarked upon as an attempt to revamp, revitalise and re-capitalise the country's ailing SOEs and thereby enabling them to operate more purposefully, contribute to national budget and also generate employment. See Sai (1988). The Divestiture programme is seen largely as an ambitious attempt to unlock the economic potential of the country, by permitting resources of people, money, and technology to be put to their best use and by increasing efficiency to achieve better living standards for all. More specifically, the programme is intended to reduce the size of the public sector and improve the performance of SOEs by mobilising private sector management and capital. This it is believed, will reduce the financial and managerial burden on government, so that the state will be able to more efficiently manage the business of government, using the proceeds from sale of SOEs to improve infrastructure, health services and education. See DIC Fact Reports, 2000.
In addition to the above, Adda (1989) identified three other important reasons as follows:

1. Changing economic environment: Most SOEs were established for reasons other than economic or financial and for many, the original objectives for their establishment was no longer tenable and considering the fact that they continued to constitute a drain on the national budget, it became necessary for their ownership to change such that, the private sector can bring a turn-around in these enterprises. Moreover, the priority of government was beginning to shift to other priorities than ownership. For example, increasing tax revenue, controlling government spending, and developing appropriate regulations to meet public policy needs.

2. Efficiency: As already noted, many of the SOEs have not been very efficient in the performance of their roles. The private sector is widely regarded as more efficient in their operations and more effective in serving the needs of their clients. Privatisation is thus expected to put these SOEs under the test of market competition in order to improve their efficiency.

3. Fairness and equity: Many SOEs compete directly with the private sector. In effect, some of them saw their own tax monies being used to compete unfavourably against them. This phenomenon is considered to be largely unfair and does not augur well for the enterprise system that the development programmes are geared to establish. Privatisation is thus expected to provide these SOEs with an equal policy and market environment to enable them favourably compete with their counterparts.
5.4 PREPARATIONS FOR DIVESTITURE

The PNDC government, in pursuance of its goal to transform the public sector (as part of the Economic Recovery Programme embarked upon in 1983) put in place a task force to crystallise its thinking on privatisation. The task force succeeded in preparing a draft policy statement on government’s thinking on privatisation. The draft policy was further subjected to vigorous debate at various public forums and seminars attended by accredited representatives of organised labour, organs of government, government officials (including ministers of state), and the public at large. The consensus emerged that there was a need for privatisation but that the programme must proceed cautiously.

Rationalisation was a key word in the policy statement and this was defined as:

The process of modifying the ownership and/or management structures of enterprises with a view to ensuring adequate capitalisation and adequate working capital, as well as the enhancement of management capacity, thereby equipping the enterprises to achieve optimum performance within a given policy, legal and institutional environment (Adda, 1989; Government policy Statement on SOEs)

Following from this, SOEs were further categorised along the following criteria: a) strategic importance, b) profitability, c) net foreign exchange earning and/or saving capability, and d) economic/financial performance; and based on this, the candidates for divestiture were identified and selected.

Further to this, was the identification of ownership structures and other arrangements that match with the nature and objective of the targeted SOEs. This saw the classification of the SOEs into: i) those that are to remain fully
government-owned, ii) fully state-owned enterprises whose management is to be contracted out to local and/or external agencies, iii) joint ventures with local or foreign participation, iv) outright sale, v) liquidation or closure, and vi) amalgamations and mergers. This was subsequently incorporated into the policy statement.

The initial program embodied in the policy statement included among others, overall policy changes (for example price liberalization) to ensure commercial operation of public enterprises, reduction and retraining of the workforce to improve efficiency, restoration of financial solvency and discipline through clearance of cross-debts and arrears, rationalisation of the public enterprises sector through privatisation and mergers. At this initial stage, responsibility for implementing the divestiture programme (together with other reforms in the public enterprises sector) was in the hands of the State Enterprises Commission. However, lack of commitment to carry out these reforms, together with doubts about the benefits of large-scale privatisation, resulted in negligible progress. That said, it was also true that an overall policy environment conducive to private sector led development had yet to be fully established in the late 1980s. As a result there were still about 350 public enterprises, and the public sector continued to be a burden on government resources. See Begashaw, 2000; Adda, 1989.
5.5 THE DIVESTITURE PROGRAMME

In 1988, a new effort to privatise SOEs began which saw the formal launching of Ghana's Divestiture Programme as part of Ghana's overall Economic Recovery Programme. The Divestiture Implementation Committee (DIC) was established which took over the divestiture responsibility from the State Enterprises Commission (SEC). However, the DIC's responsibility could not be formalised until 1993 when the Divestiture Of State Interests Law was established to provide the legal framework for divestiture. The role of the SEC was thus limited to monitoring performance of public enterprises, and more generally, advising government on restructuring, rehabilitation, and divestiture of public enterprises.

The main difference between the 1988 divestiture programme and the previous attempts was that it was formulated concurrently with efforts to liberalise the economy to attract private sector investment. Thus it was intended among others to: a) reduce or eliminate the financial burden of the public enterprise sector on the government finances, b) improve the overall efficiency of the Ghanaian economy, c) downsize the public sector, and d) refocus the role of the state in the economy.

5.5.1 The Divestiture Implementation Committee

The DIC was established in June 1988 as the implementing body for the divestiture programme. The members of the DIC comprise ministers of state, trades union, institutional and private sector representatives. The day-to-day
management of the divestiture programme is undertaken by a Secretariat headed by an Executive secretary. The members of the DIC meet regularly to consider, among other things, specific transactions negotiated by the secretariat, submitting, as applicable, recommendations to the President’s Office for approval. Specialised sub-committees on mining, cocoa, and coffee plantations assist the DIC in its operations.

The Legal Framework

In 1993, the Divestiture of State Interests (Implementation Law), 1993 (PNDC Law 326) was formulated and made to take a retrospective effect from 1st January 1988. This provided the legal framework for the DIC with the following terms of reference as its guiding principle:

1. To manage the execution of a programme of divestiture of state’s interest in such statutory boards and corporations or companies as the Government shall from time to time determine;

2. To ensure that the divestiture process is implemented in a co-ordinated, business like and timely manner;

3. To ensure consistency in procedures to be followed in proceeding with the divestiture, especially with respect to analysis required, valuation procedures, invitation of bids, negotiating the sale of shares, and settlement of claims;

4. To address, where necessary, issues that may require some uniformity across various divestiture options (e.g. redeployment/compensation);

5. To ensure that appropriate consultations are carried out and that the government’s objectives in the divestiture process are communicated effectively to the public;

6. To ensure the application of lessons from previous divestitures to new initiatives; and

7. Any other responsibilities assigned to the committee.
The Divestiture Fund

The financial implications of the divestiture programme was recognised by government from the very onset. The programme could involve potential financial net liabilities to the government on such matters as severance pay, debt settlement, and pension liabilities. To this end, a Divestiture Fund was established to handle all the proceeds and claims relating to the sale of assets. In cases where the proceeds exceed the liabilities, the surplus could be used to cover other SOEs where there are net liabilities. While the final liabilities will have to be worked out on a case-by-case basis, for fiscal planning purposes, the government will estimate the net liabilities for the divestiture programme for the following year and include an appropriate amount in its annual budget, if required. Payment of liabilities could be phased over a period to ease the possible fiscal burden. See Adda (1989).

5.5.2 Mode of Divestiture

The choice of the modality of divestiture was guided by the need to balance the desire for a speedy restart of the enterprise through new management, investment, and better know-how, against a preference toward majority ownership by nationals, and the need to prevent management and workers from forestalling the privatisation process.

Information and documentation are collected on each SOE listed for divestiture. Once that has been done, decisions are made as to whether it will be divested as a whole or fragmented for the purposes of divestiture and
the preferred mode of divestiture. Fragmentation is usually employed where, for example, the SOE comprises a number of distinct businesses or divisions. The mode of divestiture will usually be the sale to private sector investors of the SOE’s assets by competitive tender. In the case of large enterprises, the mode of divestiture involved the breaking of the enterprises into smaller units for outright sales to nationals, or finding a strategic investor who would take a significant share and management of the enterprise while floating the remaining shares on the Ghana Stock Exchange. Other options include the sale of shares (particularly where the SOE already has some private sector shareholders), the entry by the state into a joint venture with private sector investors (usually by transferring all or part of the SOE’s business and assets to a newly formed vehicle, and the state and investors taking equity stakes in that vehicle), and the leasing to private sector investors of an SOE’s assets. Where an SOE is moribund and no interest has been shown by investors, liquidation is becomes the preferred option.

The main methods so far employed are: a) Sale of assets, b) Sale of shares, c) Joint venture, d) Lease, e) Liquidation. Table 5.1 below shows a breakdown, on annual basis, the number of SOEs divested between 1991-1999, highlighting the main methods of divestiture employed.
Table 5.1: Mode of Divestiture (1991-1999)

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<td>7</td>
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<td>4</td>
<td>0</td>
<td>4</td>
<td>1</td>
<td>2</td>
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<td>0</td>
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<td>7</td>
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<td>23</td>
<td>19</td>
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<td>21</td>
<td>233</td>
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</table>

SOURCE: Divestiture Implementation Committee, August 2000.

5.5.3 Divestiture Procedures

The list of enterprises to be divested was prepared by the government following consultations among interested government agencies, including the SEC, line ministries, and the DIC itself, and then provided to the DIC. The selection criteria included the need to minimise economic disruption, impact on the economy, and maximization of future tax revenues. However, these criteria were not objectively defined and the process lacked transparency, making the choice of enterprises for divestiture somewhat arbitrary. After an SOE had been selected for divestiture, the process would begin with regular meetings (once a month) of the DIC, to decide on such issues as the amount of government shares to be divested and the modality of divestiture to be employed.
Figure 5.1


- Sale of assets: 18%
- Sale of shares: 0%
- Joint ventures: 9%
- Lease: 15%
- Liquidation: 55%
The procedure followed in any particular case will depend on a number of factors, including the mode of divestiture selected. However, where the mode of divestiture is the sale of the assets of an SOE by competitive tender (which is the most common mode), the procedure will usually be as set below. See DIC Fact Reports, 2000.
Advertisements

After the bid documents have been prepared, the SOE concerned is advertised for sale. This begins with the preparation by the DIC of a dossier, known as *information memorandum*, to be presented to potential buyers. The dossier would usually contain updated financial information, value of assets, and other relevant information on the SOE being divested. Based on the information memorandum, the selected SOEs would be offered for sale by placing advertisements in Ghanaian newspapers, and for larger enterprises, also in international publications. The advertisements usually indicate the closing date for delivery of bids; usually not less than two calendar months after the date of the first advertisement in the Ghanaian newspapers.

Obtaining Bid Documents

Investors who are interested in an advertised SOE would normally make contacts with the person indicated in the advertisement. Subject to their paying the appropriate fee and (if required) signing a confidentiality undertaking, investors are provided with the relevant bid documents. These generally comprise a detailed set of bid procedures, a draft sale and purchase agreement, the information memorandum, which, as noted above, contains a profile of the SOE and an independent valuation report of the SOE’s assets and other financial information.
Form of Bids

Bids from investors usually comprise separate qualification statements and price bids. The required contents of each of these are clearly specified in the bid procedures.

Qualification statements usually include, among other things, details about the investor and the investor's business plan for the SOE. The business plan may cover, for example, the investor's plans for the development of the SOE (with regard to both its rehabilitation and expansion) and the investors intentions with regard to employment.

Price bids include, among others, the price offered for the SOE's assets, the timing of any deferred payments, details of the security to be provided (in the case of deferred payments), and a detailed explanation of how the investor intends to finance the acquisition.

Information On Price

The DIC usually prefers the price offered to be paid in full on completion of the sale and purchase. Bids involving the payment on completion of less than 50% of the price offered or deferred payments due after the third anniversary of completion are not, except in exceptional circumstances, considered. Deferred consideration is to be secured by a guarantee from a bank or other person of sufficient standing. The DIC may consider, where appropriate, taking security over the assets until full payment is received. Also, interest is payable on deferred payments.
Due Diligence

Investors, who wish, are usually permitted to carry out site visits to inspect the SOE’s assets, operations and records, prior to submitting their bids.

Delivery Of Bids

Completed bids are usually sealed in two separate envelopes; one contains the qualification statement, and the other the price bid. Bids may be delivered by hand or post, on or before the closing date stated in the relevant advertisement and bid procedures.

Evaluation Of Bids

A two-stage procedure is usually adopted for evaluation of bids received with evaluation of qualification statements being completed prior to any price bids being opened and compared. Price bids from investors who submit unsatisfactory qualification statements are opened. In the event of equal price bids, preference is given to bids submitted by Ghanaians. Evaluation of bids is completed, wherever practicable, within one calendar month after the closing date for their submission.

Negotiations

The investor who submits the highest confirming price bid opened is invited for negotiation of the draft sale and purchase agreement and discussion of the business plan compromising part of his qualification statement.

Negotiations may include the offer (and, if relevant, the timing of deferred
payments). In the event of negotiations with an investor failing, the investor who submitted the next highest conforming price bid opened may be approached, and so on. The investor may be asked to submit a bond to the DIC before negotiations start. The bond is for an amount equal to 10% of the offer price.

**Approval and signature**

Formal approvals to any divestiture must be sought from, first, the members of DIC and, secondly, the President's Office. The length of the approval process depends on when agreement is reached with the investor, but usually takes about two calendar months. Upon receipt of the approvals, the sale and purchase agreement is signed, and the assets concerned handed over.

**5.5.4 Outsourcing**

Outsourcing is the process whereby external consultants such as legal firms, merchant and investment bankers and management consultants are appointed by the DIC to carry out divestiture work on its behalf. DIC monitors their output to ensure that assignments are performed according to its statutory obligations.

**Register of Pre-qualified Firms**

The DIC maintains a register of pre-qualified firms to undertake work on divestiture. The register is divided into the following categories:

- Management, financial and business consultants;
Legal firms and consultants;

Merchant banks and non-financial institutions;

Surveyors, valuers, estate managers and landed property consultants;

and chartered accounting firms.

Persons interested are allowed to inspect the register at the DIC’s headquarters during usual business hours.

Divestiture assignments

The major assignments will normally include:

- To provide advice in a lead capacity in connection with, and ultimately to implement the divestiture of a state-owned enterprise.

- Valuation of the land and buildings, plant and machinery and other fixed assets of an SOE;

- Financial valuation of an SOE;

- Preparation of a profile of an SOE in the form of an information memorandum.

The World Bank

The Government of Ghana has received a credit from the International Development Association (IDA) towards the cost of consultancy services, and applies the proceeds of the credit to eligible payments under outsourcing contracts. The DIC selects consultants in accordance with the World Bank guidelines for the selection of consultants.
Procedure for selecting consultants

The procedure depends on the nature and size of the assignment concerned. However, in the case of assignment to provide advice in connection with, and ultimately to implement a divestiture, the procedure is as follows:

- The DIC draws up a short list of suitable firms appearing on the register. Short-listed firms are provided with tender documentation. This generally comprises a letter of invitation, terms of reference, supplementary information for consultants and sample form of outsourcing contract.

- Proposals received from short-listed firms must comprise separate technical and financial proposals and contain the information set out in the supplementary information for consultants. Completed proposals will be sealed in two separate envelopes; one envelope containing the technical proposal, and the other the financial proposal. Proposals must be delivered, by hand or post, on or before the closing date stated in the letter of invitation.

- A two-stage procedure is adopted for evaluating proposals received, with evaluation of technical proposals being completed prior to any financial proposals being opened and compared. Technical proposals are evaluated using the criteria and weightings set out in the letter of invitation. Proposals from only those firms scoring more than seventy points (out of a total of 100 points) for their technical proposals are considered for further evaluation. Financial proposals are also given a score out of 100, also on the basis and assumptions set out in the letter of invitation. Finally, each proposal is given a combined score.
In this case, the weights given to the technical and financial proposals are 80 and 20 points respectively.

- The winning firm is invited by the DIC for negotiations. Negotiations usually start with a discussion of the firm's proposal, the proposed work plan, staffing and any suggestions made to improve the terms of reference. Agreement is then reached on the final terms of reference and the staffing.

**Invitation to register**

Invitation is open to both local and international firms not currently on the register to register their interest and qualifications to undertake divestiture work.

**5.6 DIVESTITURE RESULTS SO FAR**

Though the divestiture programme was launched in 1988, in terms of results, it did not get underway until 1990/1991. The performance so far may be taken in two phases as below.

**5.6.1 1989-1992**

During the period 1989-1992, only 59 out of the 350 SOEs operating in all sectors of the economy were divested, generating proceeds amounting to ₦21.7 billion. (See table 5.3 below). 26 of the divested firms were liquidated and produced no proceeds (21 of them in 1990 alone). These were among a substantial number of firms that did not have a viable business and for that
matter often had negative net worth. Beside these liquidations, the overall pace of divestiture during this period was very slow.

**Initial difficulties**

The divestiture programme noticed some difficulties at the initial stages. Factors contributing to these difficulties and for that matter the slow pace included: a) weakness in the DIC including the inability to process enterprises in a reasonable time period, b) lack of up to date financial and other relevant information on the public enterprises being offered for sale, c) lack of transparency of the divestiture process itself, slow process of asset valuation by the Lands Valuation Board, e) indecision on how to deal with liabilities of the enterprises, particularly, severance payments, e) lack of co-ordination among the DIC and other government bodies involved in divestiture, f) there was also the strong resistance from workers and management of the enterprises being sold who were striving to increase their share of benefits from the sale, g) the virtual dominance of the Social Security and National Insurance Trust (SSNIT) (a government organisation) in almost all areas of divestiture and thus crowding out the private investors, and finally, h) the government was initially ambivalent about the programme and sent conflicting signals to potential buyers. Beside any ideological issues there was little commitment from government officials who felt that a stronger private sector might also mean better-financed opposition parties. See SDC Investments Ltd., 1995; Dzakpasu, 2000.
5.6.2 1993-1999

In 1992, the macroeconomic performance of the country suffered a major setback, following a pre-election civil unrest that forced the government to grant large wage increases as well as incur other expenditures aimed at obtaining the support of key pressure groups. This led to a sharp deterioration in the fiscal position of the government and a dramatic rise in the level of inflation. Faced with this situation, the government had to find a way to adjust the fiscal position quickly, but at the same time, did not want to cut expenditures by as much as would be needed to reverse the fiscal deterioration. As a compromise, the government chose to tackle the fiscal problem largely through floatation on the stock exchange of its shares in some of its most profitable enterprises. See Begashaw/IMF, 2000

Procedural changes

In order to regain momentum and also enhance the contribution of divestiture to economic efficiency, an accelerated divestiture phase was envisaged in support of which IDA approved in July 1995 a Private Sector Adjustment Credit (PSAC) amounting to SDR46.9 million, complemented by technical assistance from the UK's Department for International Development (DFID)\textsuperscript{24}. This new approach to divestiture introduced several changes designed to improve the efficiency of the DIC. The changes involved the following steps:

1. The DIC, which previously consisted of only government officials, was modified in early 1995 to include two members from the private sector,

\textsuperscript{24} IDA (1998)
and a representative of trade union. This change was expected to increase transparency and involve other stakeholders in the divestiture process. The DIC also established a communications office to educate the public at large on the merits of divestiture and to solicit inputs into the divestiture program. It also agreed to meet more frequently than the once a month schedule that existed before 1995. See SDC Investments Ltd (1995); IDA (1998); IMF (2000).

2. To improve its efficiency and accelerate the pace of divestiture, the DIC began employing suitable private consultants for the preparation of information memoranda required to offer SOEs for sale. A new divestiture procedures manual was introduced, and both the DIC and the private sector consultants were required to use the same standard procedures to divest enterprises.

3. Also, the DIC set for the first time explicit targets for divestiture. Under the IDA PSAC approved in 1995, a list of 114 public enterprises were specified, of which 46 medium-sized and 64 small-sized enterprises were to be divested and 4 large and strategic ones were to be prepared for divestiture. The strategic enterprises earmarked included the Ghana Telecom, State Insurance Corporation, State Housing Corporation, and Mim Timber. This list was later expanded to include a total of 149 enterprises from which divestiture targets of 34 medium and the 4 large and strategic enterprises were set by the DIC for the period September 1995-October 1997.
The pace of divestiture accelerated during 1994-96 when 79 public enterprises valued at $756.6 billion were divested. (See table 5.2). The divestiture for this period included sales of government interests in Ashanti Goldfields (US$462.4 million), state-owned banks (US$65.2 million), a strategic stake in Ghana Telecom (US$38 million). Others include Tema Food Complex Corporation (for US$14 million); Ghana Oil Palm Development Corporation (US$7 million); GNTC Bottling (US$7 million); Ghana National Manganese Company (US$4 million) and; Ghana Rubber Estates Ltd. (French Francs 21 million). (See table 5.3).

However, from 1997 to September 1999, the pace of divestiture lost momentum and only 44 enterprises valued at $245.4 billion were divested.

Over the period 1993 to September 1999, a total of about 133 enterprises were divested, including manufacturing enterprises, such as textiles and matches, farms, real estates units, hotels, and departmental stores. Of the 133 enterprises, 29 were divested through the sale of shares, 77 through outright sale, 12 were liquidated and 12 were divested through joint ventures. Large enterprises like the Ghana National Trading Corporation (GNTC), State Fishing Corporation (SFC) and State Hotels Corporation were disintegrated into smaller units so that local investors could have the opportunity to compete in their acquisition.

Statistics from the DIC show that by the end of 1998, local entrepreneurs had bought about 80 per cent of the divested enterprises. An important
observation with privatisation processes in Africa is that, whenever nationals purchase a divested firm, they are more likely to buy it on credit than on cash basis compared with foreign buyers. Again, nationals are more likely to default or request delays in payments agreed when purchasing the enterprise. Ghana’s privatisation process is no exception to this observation.
### Table 5.2: Summary of Divestiture Proceeds 1989-September 1999 1/
(In millions, unless otherwise specified)

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<td>21.0</td>
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<tbody>
<tr>
<td><strong>III. Divestiture proceeds outstanding</strong> 4/</td>
<td></td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>Cedis</td>
<td>18</td>
<td>0</td>
<td>68</td>
<td>0</td>
<td>85</td>
<td>0</td>
<td>6,416</td>
<td>12,311</td>
<td>2,450</td>
<td>18,726</td>
<td>21,176</td>
<td>21,262</td>
</tr>
<tr>
<td>US dollars</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>1.5</td>
<td>1.5</td>
<td>0.3</td>
<td>20.2</td>
<td>16.6</td>
<td>37.5</td>
<td>37.1</td>
<td>74.5</td>
<td>76.0</td>
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<tr>
<td><strong>IV. Total</strong></td>
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<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>In millions of cedis 5/</td>
<td>18</td>
<td>0</td>
<td>68</td>
<td>4,005</td>
<td>4,090</td>
<td>668</td>
<td>60,430</td>
<td>56,553</td>
<td>102,495</td>
<td>117,650</td>
<td>220,145</td>
<td>224,235</td>
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<tr>
<td>In percent of end of period GDP</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
<td>0.1</td>
<td>0.1</td>
<td>0.0</td>
<td>0.6</td>
<td>0.3</td>
<td>0.5</td>
<td>0.7</td>
<td>1.1</td>
<td>1.1</td>
</tr>
</tbody>
</table>


1/ Including those enterprises divested through the DIC and outside the DIC framework
2/ 1999: January to September
3/ Calculated using average exchange rate for the period
4/ As at end September 1999
5/ The values in foreign currency are valued at end September 1999 exchange rate.
Table 5.3: Divestiture of SOEs Outside the DIC, 1989-September 1999

<table>
<thead>
<tr>
<th>SOEs</th>
<th>Date of Privatisation</th>
<th>V. Sale of Shares</th>
<th>Total 1/</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>US$ 1/</td>
<td>Cedis 2/</td>
</tr>
<tr>
<td>Ashanti Goldfields Company</td>
<td>1994</td>
<td>293.75</td>
<td>60,900</td>
</tr>
<tr>
<td></td>
<td>1996</td>
<td>105.00</td>
<td>0</td>
</tr>
<tr>
<td>Social Security Bank</td>
<td>1995</td>
<td>23.64</td>
<td>12,021</td>
</tr>
<tr>
<td>Merchant Bank</td>
<td>1995</td>
<td>6.28</td>
<td>10,500</td>
</tr>
<tr>
<td>Ghana Commercial Bank</td>
<td>1996</td>
<td>0.00</td>
<td>32,796</td>
</tr>
<tr>
<td>Ghana Telecom</td>
<td>1996</td>
<td>38.00</td>
<td>0</td>
</tr>
</tbody>
</table>

SOURCE: Divestiture Implementation Committee (2000)

1/ In millions of US dollars
2/ In millions of cedis.
Table 5.4: Transfers to Government of Ghana

<table>
<thead>
<tr>
<th>Year</th>
<th>Currency</th>
<th>Amount (in Cedis)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1991</td>
<td>£3,000,000.00</td>
<td>1,800,000,000.00</td>
</tr>
<tr>
<td>1992</td>
<td>5,000,000,000.00</td>
<td></td>
</tr>
<tr>
<td>1993</td>
<td>2,500,000,000.00</td>
<td></td>
</tr>
<tr>
<td>1994</td>
<td>4,000,000,000.00</td>
<td></td>
</tr>
<tr>
<td>1995</td>
<td>£5,100,000.00</td>
<td>6,120,000,000.00</td>
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<tr>
<td>1996</td>
<td>220,642,343.18</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>£6,000,000.00</td>
<td>12,597,840,000.00</td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td>32,238,482,343.18</td>
</tr>
</tbody>
</table>

Breakdown Of Transfers

<table>
<thead>
<tr>
<th>Currency</th>
<th>Amount (in Cedis)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pounds</td>
<td>3,000,000.00</td>
</tr>
<tr>
<td>Dollars</td>
<td>11,100,000.00</td>
</tr>
<tr>
<td>Cedis</td>
<td>11,720,642,343.18</td>
</tr>
<tr>
<td>Total</td>
<td>32,238,482,343.18</td>
</tr>
</tbody>
</table>

5.6.3 Overview of Key SOEs Privatised

Available data from the DIC indicate that most of the SOEs divested have been modernised and brought back into production. We take a brief look at some of the key firms usually described as the success story of Ghana’s divestiture as below.

Golden Tulip Hotel (Formerly Continental Hotel)

Prior to its divestment in 1990, the hotel was operating in poor conditions and had difficulties paying workers wages, which were in arrears. It employed 116 employees and had about 130 rooms. Following divestiture, the hotel was transformed through new investment, staff training, and additional employment. The number of employees has risen to 350 and the number of rooms has gone up to 234, with the quality of services dramatically improved.

West African Mills Company

This company is made up two factories – WAMCO I, and WAMCO II, with installed capacity of 230 tonnes of cocoa beans per day. Since taking over the enterprise in 1992, the new German owners have invested over DM30 million, salvaging it from imminent collapse. They also saw to the installation of new equipment under a rehabilitation and modernisation exercise. This saw the processing of cocoa beans going up from about 10,000 metric tonnes in 1992 to 25,414 metric tonnes in 1999, utilising about 52 per cent of its installed capacity. Total number of employees also rose from 170 in 1992 to 450 in 1999.
Tema Steel Company (Formerly GIHOC Steel)

This company had practically ceased operations before divestiture. After its divestiture in 1991, the new owners undertook a major rehabilitation programme, investing more than US$572,000 in the exercise. The company now produces various sizes of high tensile and mild steel rods and billets. In the melting shop, production level has gone up from the pre-divestiture level of 6,300 tonnes per year to 30,000 tonnes per year as at 1997. Also, the conversion efficiency of rolled products from billets from the melting shop has shot up to 88 per cent. Overall production level has soared from the pre-divestiture level of 4,500 tonnes per year, to 21,500 tonnes per year. Employment also rose from a low level of 130 before divestiture, to a current level of almost 600. Further, the firm’s capacity utilisation has increased from about 2 per cent in 1990, to 90 per cent in 1999. Financial performance has also shown a remarkable improvement. The trend of losses recorded prior to divestiture has been reversed. The company is now profitable and has paid about $555.4 million to the government for its 40 per cent shares for 1997 and 1998 alone.

Ghana Agro-Food Company (GHAFCO)

GHAFCO, formerly the Tema Food Complex Corporation, is a joint venture between the Government of Ghana (25 percent) and the Industrie Bau Nord AG, a Swiss company with several years of operating experience in Africa (75 per cent). A complete rehabilitation of all four industrial plants has been undertaken since divestiture, and they have since been fully operational.
Again, employment level has increased from the pre-divestiture level of 494 to the current level of 930 and salary levels have increased more than three times the level before divestiture. Capacity utilisation has also gone up since divestiture, from 45 per cent to 85 per cent.

**Coca Cola Bottling Company of Ghana (Formerly GIHOC Bottling)**

This is another joint venture with the Coca Cola International and a private American citizen holding a total of 71 per cent and the Government of Ghana 29 per cent. Following the divestiture, a new plant worth US$20 million was constructed in 1997, to date, the company has invested US$47 million in manpower, vehicles, glass bottles, plastic crates, production and marketing equipment. A second bottling line worth US$10 million was commissioned in 2000 increasing countrywide capacity from 2000 crates per hour in 1995 to 4000 crates per hour in 2000. Market share and sales volume of Coca Cola products had increased steadily with production going up from about 2.8 cases in 1995 to 10.4 cases in 2000. Employment level has also gone up from 372 in 1995 to 684 in 2000. More than ¢36 billion has been paid to government as taxes and duties as at August 2000.

**Ghana Oil Palm Development Company Limited (GODPC)**

The GOPDC was privatised in 1995 with the Government of Ghana retaining 20 per cent shareholding, the SAIT Consortium of Belgium 60 per cent, and the smallholders/out growers 20 per cent. Prior to divestiture, the oil palm mill capacity was 30mt per hour. This has increased to 48mt per hour by 2000 and further improvements for efficiency are being introduced. A 45mt/hr palm kernel processing plant and palm oil storage facility with a
capacity of 6,200mt to facilitate export of palm oil and palm kernel oil was also installed at Tema. At the time of divestiture, the out grower programme had reached 7,666 hectares. Between 1995 and 1999, an additional 4,834 hectares of out grower plantings had been made. More than US$9.6 million has so far been invested since divestiture. GOPDC offers employment to an average of 1,500 persons a year. It also offers employment to 6,000 farm families as a result of the out grower scheme.

Ashanti Goldfields Company (AGC)
Following its privatisation, AGC has been able to tap international capital markets for investment in new equipment and technology and to expand its operation in Ghana as well as in other countries. Following its successful listing on the Ghana Stock Exchange in March 1994 the company has subsequently been listed on other stock exchanges, including those of New York, London, Toronto, and Zimbabwe. It currently has operations in the Democratic Republic of Congo, Guinea, Tanzania, and Zimbabwe. As a result of investment in new technology, AGC's gold production rose from 1.17 million ounces in 1997 to 1.57 million in 1998, and its cost of production declined from US$254 per once to US$217 during the same period.

5.7 OBSTACLES TO THE DIVESTITURE PROCESS
The initial acceleration of divestiture (during 1994-96) could not be sustained in later years. The performance of some of the state-owned enterprises remained a source of worry. Their contribution to economic growth has
remained consistently below their potential, and they have, in the main, imposed a significant burden on the government. The divestiture of most of these firms has been postponed and ultimately sidetracked, despite clear evidence that a decisive move would have been in the best interest of the country. Some of the reasons accounting for this unfortunate phenomenon are discussed below:

1. Questions of eligibility of an SOE

Workers, especially in firms that had not been totally inefficient, had challenged the original inefficiency argument for the divestiture of SOEs. The government subsequently had to design new selection criteria that took into account the need for sectoral balance in the economy. In line with the recognition that inefficiency and non-viability alone cannot be the criteria for privatisation, the thirty SOEs earmarked for initial divestiture had to be selected from various sectors of the economy, namely, manufacturing, agriculture, the cocoa sub-sector, tourism, transport, construction, and commerce.

2. Organisation and Logistic problems

One of the major problems in the implementation of the divestiture programme was the delay in organising the logistics necessary for a smooth, business-like take-off (e.g. vehicles, office machinery, etc.). The DIC was inaugurated in August 1987 and started attending to the logistics in February 1988.
However, lack of dynamism on the part of the DIC itself in preparing SOEs for divestiture has been noted as an important factor in the slow progress of the divestiture programme. This is particularly so in the case of large and strategic enterprises, and in the selection of consultants for outsourcing. The outsourcing itself was aimed at accelerating divestiture, increasing transparency, helping the DIC play a more supervisory role, and increasing revenue from the sale of SOEs. These objectives were far from being achieved. This was largely attributed to inexperience in divestiture by local private consultants, lack of transparency in their selection, and the inadequate preparation for privatisation of some of the SOEs.

Moreover, the divestiture manual, which was to outline agreed norms and standards for divestiture to be used by both the DIC and the private consultants, came out only in 1997, which was a significant delay.

3. Lack of proper records

The divestiture programme contains certain actions, which have to be completed so that other actions can commence. One of such actions is the preparation of dossiers on the companies for divestiture. Difficulties being encountered here stem from the fact that, most of the enterprises did not have audited financial records for many years, as most of the SOEs did not have people with the requisite skills to prepare the accounts. Steps have had to be taken by the DIC to get the accounts of all SOEs prepared to date and subsequently audited.
4. Valuation of Company Assets

The main difficulty here arises from the writing of valuation reports. The Land Valuation Board (LVB) has organisational and logistical bottlenecks that make it difficult for them to cope with the volume of work, and thus hampering the work of the DIC. To forestall this problem, the DIC had resorted to the use of private valuers where necessary, but this also has the potential of making the programme very expensive as the fees demanded by these valuers are on the high side.

5. Legal Issues

Some other difficulties arise in the case of confiscated companies because there was no law backing the confiscation of these assets. Often the DIC had to intervene to cause the appropriate legislation to be enacted. Also it was difficult to identify some of the assets, as most of them were not covered by proper documents by their former owners due perhaps to the illegal nature of their acquisition. This was particularly so in the case of the smaller confiscated companies, which were in fact part of larger groups of companies. Some of the enterprises did not even have titles to the land that they occupied.

Again, a cumbersome legal and regulatory environment, of which the difficulty in transferring land titles has been an important example, continued to beset the divestiture process.
6. Plantations for divestiture

This is one area where difficulties of a political, organisational, economic, legal, and even social nature have been encountered mainly in the divestiture of cocoa and coffee plantations belonging to the Ghana Cocoa Board (GCB).

The GCB was the first to announce the sale of its plantations to both local and foreign private investors. However, further action by the DIC on this programme shows that there are many difficulties to be surmounted. Issues that have confronted the DIC include: a) land acquisition; b) payment of compensation; c) legal title to the lands; d) problems associated with valuation of the farms by the Lands Valuation Board; e) incentives to the investors; f) production and sale of cocoa and coffee beans by the private foreign investor; and g) the reaction of local cocoa farmers and traditional councils to the sale of farm lands. There was also the problem of reconciling acreages declared by the Cocoa Board as acquired and cultivated with the actual plantations that existed. The sensitive nature of these problems called for political will on the part of government, the absence of which has resulted in delays in presenting these plantations for divestiture.

7. Country Risk/ Perceived Political Risk

Some actions of government in the past (for example confiscation and subsequent nationalisation of private businesses) have left deep scars in the minds of many a potential investor, both foreign and domestic. There is still uncertainty among Ghanaian businessmen as to whether the government had really changed its attitude towards private enterprise, after all the years of dirigisme and anti-business behaviour. Also, the much-needed foreign
investment is not forthcoming because of perceived political instability in the minds of foreign investors (mainly as a direct consequence of the country’s history of coup d’etats and political upheavals). It should be noted however that these fears have been allayed by the adequate provision of security for investments by the Constitution of the Republic of Ghana, the Multilateral Investment Guarantee Agency (MIGA), and other Investment Promotion Protection Agreements.

8. Lack of Finance and Absence of a Vibrant Stock Exchange

The domestic population is mostly illiquid. As at the beginning of the divestiture programme, the banking and credit system was in desperate shape, and the only likely domestic buyers were the distrusted and discredited upper class, the so-called political opponents. In addition, the financial systems were very weak. For example, the five major banks had a total of US$2.1 million for acquisition financing, while the estimated value of the SOEs up for sale in the first round exceeded US$25 million, that is more than the total worth of the banks. The situation is made worse by the absence a sufficiently developed capital market to handle equity sales. The Ghana Stock Exchange started operations as late as 1990 and was still in its teething stage.

9 Undue Bureaucracy

There was undue interference by officials and interested parties, indecision and unwillingness to divest certain public enterprises for political and “strategic” reasons. Decisions were often postponed for various reasons,
including the absence from the country of key DIC members. The divestiture process itself, which required approval of final sale by the President’s Office, proved to be too drawn out, on occasion giving rise to unwarranted consultations with “interested” parties and extending the period required for final approval of sale.

10 End-of-service Benefits (Redeployment of Labour)

Over-staffing was a peculiar problem with most SOEs in Ghana and it was obvious that the government may either have to lay off large numbers of employees before divestiture, or must allow the new owners to scale down the work force to an appropriate level. A complicating factor however was that most of the enterprises had previously agreed to overly generous severance pay and retirement benefits in collective bargaining agreements. Severance payments in many SOEs are about 65 per cent higher than in the private sector, with payments estimated to be 52 months, or 4.3 years of base pay. Between 1985-1991 liabilities for end of service benefits grew by 150 per cent, reaching between ₋0.5 million and ₋1.0 million cedis per employee (i.e., US$1,423-US$2,846) representing six to seven times the country’s per capita GNP. The colossal amount involved is obviously beyond the reach of government, and most private investors are not interested in purchasing the SOEs if they had to honour these commitments.

Early in the privatisation process, the government elected to pay off the end of service benefits from sale proceeds. However, proceeds continued to fall far short of liabilities, and the government had to arrange to supplement the
benefits with annual budgetary contributions. Thus, with the help of a World Bank Structural Adjustment Loan, the government set aside in its 1991 budget ¢3.5billion for end of service benefits. These allocations have not been sufficient and the problem of severance payments has continued to slow down the process of privatisation.

To date, the government has taken a number of steps to deal with the financing problem. Legislation has since been drafted to standardize and rationalize severance benefits, and more recent privatisations have shown significantly lower levels of severance payments, averaging 10 months. In addition, the World Bank supported Programme of Action to Mitigate the Social Cost of Adjustment (PAMSCAD) has also devoted some resources to provide compensation packages to retrenched workers.

11 Undue concentration on small firms

The divestiture programme so far has concentrated mainly on small and medium sized enterprises, as many large (and even some medium-sized) public enterprises are still yet to be divested. Among the key firms that have seen a lot of feet-dragging are the Ghana Airways, Electricity Company of Ghana, Tema Oil Refinery, Produce Buying Company, Ghana Commercial Bank, Ghana Railways Corporation, State shipping Company, National Investment Bank, and the State Insurance Company. The targets set under the Private Sector Adjustment Credit (PSAC) (noted above) could not be achieved as only 50 enterprises had been divested by early 1988.
12 Democratisation

The democratisation of the Ghanaian society beginning in the early 1990s has also played a major role in the divestiture process as it calls for more transparency in the process. Parliament has shown interest in the divestiture process by requiring more information on the sale of key public enterprises, and in some cases, has been vocal in opposing the divestiture of some "strategic" enterprises. Workers and management of certain public enterprises have at times voiced their opposition to sales of enterprises to outside investors and suggested worker-management buy-outs. This problem is considered in more detail below.

13 Peculiar problems in the divestiture of "strategic" enterprises

Some problems have been encountered in the divestiture of a number of firms classified as "strategic" by virtue of the nature of their operations. We take a brief look at three key examples as below:

Ghana Oil Company (Goil). The attempt to sell GOIL in 1998 was delayed because of the need to enhance transparency in the choice of the investment advisor. Following the offer for sale of GOIL in October 1998, some members of parliament voiced concern regarding its sale as a strategic company. A worker-management group was put in place to make a bid for the company and to oppose the sale of a controlling interest in the company to a single investor. In early 1999, bids from Total Ghana Ltd., Engen of South Africa, and from the GOIL Consortium representing a workers-management group were evaluated and recommendation was made by DIC
to the President's office. The President's Office has asked the DIC to make sure that proper transparency procedures had been followed before it would give final clearance for the sale. This has dragged on to date.

**Produce Buying Company (PBC).** Members of parliament, government officials, including cabinet members, farmers, the staff of PBC, and the Ghana Cocoa Board, have also opposed the divestiture of the PBC at one time or the other. This is beside the fact that the sale is a key element of the medium-term cocoa strategy approved by cabinet after a lengthy process of stakeholder consultation. The sale of the PBC was first decided in 1996. It was then delayed pending the formulation of a medium-term cocoa strategy. A proposal to divide PBC into three companies was then floated, but was discarded in 1998, as it was felt that it could result in lengthy discussions regarding the division of the company's assets, which could delay the whole process. A proposal to sell PBC to a strategic investor was also blocked in 1998 as the mode of divestiture was seen as favouring large foreign investors. Subsequently, the government decided to float 50 per cent of PBC shares on the Ghana Stock Exchange to allow wider participation by Ghanaians. Of the remaining shares, 20 per cent will be given to farmer groups, 5 per cent to PBC employees and the government will retain the other 25 per cent. The sale was not completed until the end of 1999. To ensure a level playing field among the companies engaged in the domestic cocoa marketing, PBC was stripped of some of Ghana Cocoa Board's assets that it used freely in the past.
Tema Oil Refinery (TOR). The divestiture of TOR has also been delayed, partly to rehabilitate the refinery and to accommodate opposition to its sale by several groups, including members of parliament (mainly the opposition) and government officials, because of its strategic nature. Following the decision to divest TOR, and its valuation by investment advisors in 1998, it was decided that the process be delayed to allow for the financial restructuring of the enterprise. The restructuring process resulted in the creation of two General-Manager positions for the two major divisions of the enterprise, namely, petroleum trading, and refinery activities. The analysis carried out during the financial restructuring revealed that the main profit centre of TOR is its trading activities and that there was the need for the government to ensure that the sale goes to a strategic investor with expertise in petroleum trading.

5.8 THE IMPACT OF PRIVATISATION

Notwithstanding the numerous problems noted above, the divestiture programme has to date made some notable achievements. In the first place, the sale of SOEs has generated some revenue for the national treasury, and the proceeds have been important in financing fiscal deficits since 1993. (See table 5.2). Also, divested enterprises have generally achieved a vigorous expansion in production, owing to investment in new technology and in increased capacity utilization, as noted with some of the key enterprises discussed above. Further, privatisation has attracted substantial foreign investment into the country. Conflicting data however makes this difficult to
measure. The World Bank's 1997 Country Assistance Strategy for Ghana says net private foreign direct investment (FDI) rose from US$25 million in 1993 to US$35 million in 1995 before falling back to US$20 million in 1996. But the Bank's Global Development Finance (also 1997) puts net FDI at US$125 million, US$233 million and US$230 million respectively for the same years. We however take a closer look at some areas where the impact of privatisation has been very conspicuous as follows:

5.8.1 Impact of Privatisation on the Ghana Stock Exchange

The Ghana Stock Exchange was given recognition as an authorised stock exchange under the Stock Exchange Act of 1971 (Act 384) in October 1990. Trading on the floor of the exchange commenced on November 12th 1990 with 11 listed companies and a total market capitalisation of ₴33.9 billion. The number of listed companies increased to 13 in 1991, 15 in 1992, 17 in 1994, 21 in 1996, and has stagnated at 22 from 1999 to date. Similarly, market capitalisation to ₴95.7 billion in 1993, ₴2.4 trillion in 1995, ₴2.6 trillion in 1996, and ₴4.2 trillion as at May 2002. It is worthy to note, however, that new listings of companies have been more influential in the growth of market capitalisation than rapidly increasing share prices. This is where the role of privatisation becomes very notable.

To date, the government has off loaded varying percentages of its shares in 9 SOEs on the Ghana Stock Exchange. Of these, four enterprises namely Ashanti Goldfields Company (AGC), Ghana Commercial Bank (GCB), SSB Bank Limited (SSB and the Pioneer Aluminium Factory (PAF) have made the
most impact on the stock market. In 1994, the government of Ghana floated publicly, 30 per cent of its holdings in the giant Ashanti Goldfields Company (AGC). This brought the company onto the GSE and added $62.53billion to market capitalisation. A second AGC issue between May and June 1994 added a further $2.815billion to market capitalisation. In August 1995, the government sold off its equity stake in the Pioneer Aluminium Factory and followed it soon after by the divestiture of government (SSNIT) equity in the Social security Bank (SSB), paving the way for the SSB Bank to be listed on the GSE. The result was a further increase in market capitalisation by $12.02billion. Then in the first half of 1996, government sold 40.8 per cent of its holdings in the Ghana Commercial Bank (GCB), the country's largest commercial bank, adding about $89.3billion to market capitalisation. The contribution of these four listed companies can be re-captured as follows:

- Their listing has increased investment choices available to investors on the Ghana Stock Exchange.
- Together, they account for 73 per cent of total market capitalisation.

It is worth noting that while market capitalisation and its rate of growth over time is an important determinant of stock market size, it is at the same time an important ingredient of market development indicators such as the market capitalisation ratio (which measures the ability of the stock market to mobilise capital and provide significant opportunities for investors to diversify risk on economy-wide basis).

- They have consistently featured in the top ten most active equities (by trading volume and value) selected by the GSE on monthly basis.
Thus they can be said to have improved both the turnover and total value traded ratios on the GSE. The importance of the turnover and total value traded ratios lies in the fact that when combined, they indirectly measure market liquidity. Singularity however, the total value traded ratio captures trading relative to size of the economy while the turnover ratio measures trading relative to size of the stock market. These equities have thus helped to improve liquidity on the GSE.

- These four equities have been responsible for 45.1 per cent of total shares traded for 1997, 37.5 per cent of total shares traded in 1998, and 40 per cent in 2001.

From the foregoing, it becomes obvious that privatisation of SOEs through the capital market has played a significant role in the development of the Ghana Stock Exchange. The listed companies themselves have sought, since their listing, to maintain shareholder and investor confidence. This they have done by pursuing efficiency and improving their competitive stance in their various industries.

It has been argued however that the overall role that privatisation can play in the development of the stock market has been seriously undermined by government’s over-emphasis on privatisation through strategic investor financing rather than through the stock exchange. The impact of the four enterprises noted above is thus generally seen as just the tip of the iceberg. It is worth noting that out of the 233 enterprises so far divested, only 9 have had their shares off loaded by government on the stock exchange. Beside
strategic investor financing, the other preferred modes of divestiture have been sale of assets, sale of shares (not public but private), joint ventures, lease and liquidation.

Government has consistently professed its intention of floating its shares in some large and profitable enterprises like the Ghana telecom, Tema Oil Refinery (TOR), and the State Insurance Company (SIC) but for close to six years, the Initial Public Offering has not been effected. Again many of the SOEs operating under the Performance Monitoring and Evaluation System (PMES) of the State Enterprises Commission are doing well enough to meet the listing requirements of the GSE, yet none of them has been listed. In spite of the disappointing approach of government in using privatisation to develop the stock market, the potential cannot be overlooked. Sale of government equity on the GSE will also provide the general populace with an opportunity to participate actively in the privatisation process in their own small way. This will further to broaden the support base of the privatisation programme in Ghana. The onus therefore lies on the government, the State Enterprises Commission, and the Divestiture Implementation Committee to find ways of upgrading loss making enterprises to meet listing requirements and the floating of more equities on the GSE so that the optimum effect of privatisation on the development of the stock market will be felt.

5.8.2 Impact of Privatisation on Employment (Social Implications)

Some statistics available point to the fact that, in most of the success stories of privatisation, the newly privatised firms have been able to turn their
fortunes around with increased production and, for that matter, their staff requirements. Table 5.5 shows some positive results of newly privatised firms with regard to employment levels. The story however is not the same for a vast majority of privatised firms; at least not in the short term. As noted earlier in this study, the standard conditions for efficient privatisation are that proceeds are maximised, right buyers are selected; employment is safeguarded and social costs minimised at least in the medium to long term; and management practices are conducive to improved performance. However, with regard to issues of employment protection and its related social problems, there is enough evidence to suggest that it has not been possible to contain the situation at least in the short term.

Table 5.5: Effect of Privatisation on Employment levels of privatised Firms.

<table>
<thead>
<tr>
<th>Name of Enterprise</th>
<th>Number of Employees</th>
<th>Percentage Change</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Pre-divestiture</td>
<td>Post-divestiture</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Golden Tulip Hotel</td>
<td>116</td>
<td>346</td>
</tr>
<tr>
<td>Tema steel Company</td>
<td>130</td>
<td>430</td>
</tr>
<tr>
<td>West African Mills Company</td>
<td>170</td>
<td>345</td>
</tr>
<tr>
<td>Ghana Rubber Estates Ltd.</td>
<td>3,085</td>
<td>3,833</td>
</tr>
<tr>
<td>Coca Cola Company Ltd.</td>
<td>340</td>
<td>636</td>
</tr>
<tr>
<td>Ghana Agro Food Company</td>
<td>494</td>
<td>930</td>
</tr>
</tbody>
</table>

SOURCE: Divestiture Implementation Committee. (2001)
Again, as observed earlier in this study, most SOEs have, among other objectives, been concerned with social welfare issues by providing employment and often satisfied with a modest, break-even position. SOEs in Ghana have, in the main, recruited and retained an excessive number of staff relative to the workload. As part of the divestiture procedure, the government has had to take the hard decision to reduce the staff levels to match the workload. The usual trend is to make all employees redundant, paying them their end of service benefits and severance pay, so that the new owner can then start on a clean slate. Employees retained are offered new contracts of employment, and as has mainly been the case, not all of them are able to find their way back into the new firm. Divestiture thus becomes a traumatic experience for the larger number of employees whose services are terminated. The rippling social effect of this situation is illustrated in the story of the African Timber and Plywood (AT & P) Ghana.
Figure 5.3

Effect of Privatisation on Employment levels

AT & P is a typical example of the case where an SOE happens to be the major employer in a town or community. It represents the situation where a wholesale redundancy of employees can have disastrous effects on the very socio-economic fabric of an entire community or township. Close to 5,000 people are dependent on the 1,250 employees of AT & P. The company had a loan facility to upgrade its facilities, but much of the loan was mismanaged.
Things were not helped any better when the company lost some valuable assets, which were not insured, in a fire outbreak. The company could not continue in any viable operations without further substantial investments, and in the circumstances, had to lay off most of its labour force, thus creating serious socio-economic problems in a community that looked up to it for its sustenance. Another example is the case of Sabbat Motors (Formerly ATS) where the company has been unable to continue in operation, let alone paying workers benefits. An even more traumatic experience is created when, owing to management failures, productive jobs cannot be created in the medium term in the privatised companies. The avoidance of such situations depends on management improvements to enhance internal organisational efficiency and also put in place strategies and plans to deal with external environmental factors that impact on the enterprise. The importance of an improved management system, managerial competence, favourable attitudes and motivations for divested SOEs cannot therefore be overemphasized.

Ghana was one of the first countries where a conscious 'Programme of Action to Mitigate the Social Costs of Adjustment' (PAMSCAD) was introduced, as a joint initiative of the Government, UNICEF and the World Bank. A total of US$83 million was programmed, to be spent over two years on 23 projects in five main areas: community initiatives, employment generation, actions to help retrenched workers, basic needs of vulnerable groups, and education. As of 1990, however, an evaluation report graded only eight of the projects as having made 'good progress'. The report claimed
that PAMSCAD faced inadequate recurrent funding, political interference, and too much bureaucracy. Another major weakness was that although the international agencies accepted the idea that adjustment should be given a 'human face', PAMSCAD was never properly integrated into the SAP. In practice it brought little support to those facing hardships induced by the SAP but addressed pre-existing social problems. There are limited data for a 'before and after' comparison, suggesting that most retrenched workers faced substantial income losses. More widely there is evidence that privatisation (as part of the wider adjustment programme) was associated with a slight reduction in poverty in Ghana between 1988 and 1992, although about a third of the population still belonged to the 'severe poverty' class and a large number of retrenched workers have had their lives changed for the worse.
Statistical analysis of pre and post divestiture employment

Notwithstanding the discussion above, this study further conducted a hypothesis testing based on table 5.5 above and the results summarised as below.

Summary (Anova single factor)

<table>
<thead>
<tr>
<th>Groups</th>
<th>Count</th>
<th>Sum</th>
<th>Average</th>
<th>Variance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Column 1</td>
<td>6</td>
<td>4335</td>
<td>722.5</td>
<td>1360816</td>
</tr>
<tr>
<td>Column 2</td>
<td>6</td>
<td>6520</td>
<td>1086.667</td>
<td>1859972</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>CE of Variance</th>
<th>SS</th>
<th>df</th>
<th>MS</th>
<th>F</th>
<th>P-Value</th>
<th>F Critical</th>
</tr>
</thead>
<tbody>
<tr>
<td>Between Group</td>
<td>397852.1</td>
<td>1</td>
<td>397852.1</td>
<td>0.247053</td>
<td>0.629904</td>
<td>4.964591</td>
</tr>
<tr>
<td>Within Group</td>
<td>16103939</td>
<td>10</td>
<td>1610394</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>16501791</td>
<td>11</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

The null and alternative hypothesis are given as:

H₀: "Average employment levels of SOEs have not changed significantly after privatisation"

Hₐ: "Average employment levels in SOEs have increased after privatisation"

The above hypotheses were tested by using the F-test. The summary table above shows that F = 0.247053, and P-value = 0.629904. A large P-value suggests that the null hypothesis cannot be rejected. We may thus conclude that there has not been any significant change in employment levels following

The importance of this finding is that, if the so-called 'success stories' have not produced any significant change then employment is sure to have decreased significantly in other privatised firms that are not doing too well. And for that reason generalisations about the success of the divestiture programme based on these few 'successful firms' should best be avoided and efforts directed at addressing the pertinent problems identified earlier in this chapter.

5.9 SUMMARY
This chapter has taken us through the entire process of Ghana’s efforts at privatisation. We began by identifying the objectives for the programme and also took a look at the earlier preparations made towards the eventual take off. We examined in detail the divestiture programme itself with much emphasis on the procedures adopted, results achieved so far, as well as some observable problems that have caused undue delays in the process. A selected number of privatised firms that have for long been branded as the ‘success story’ of Ghana’s divestiture programme was briefly reviewed. The final section covered a brief assessment of the impact of the privatisation programme on the growth and development of the Ghana Stock Exchange as well as its impact on employment and its accompanying social implications.
It should be noted however, that data unavailability had made virtually impossible any in-depth analysis of the programme of divestiture in Ghana, in this chapter. It is interesting to note that the main source of data available is the bits and pieces of information published by the DIC, which are largely aimed at telling the good side only of the story. Added to this, most of the available data are outdated and do not talk much about current trends in the process of privatisation. Again, a critical assessment (comparison of pre and post-divestiture performance) of privatised firms was hindered by the absence of pre-divestiture records, and the reluctance of most firms to release such records even when available.

These drawbacks notwithstanding, we have, in this chapter, been able to digest most of the important issues involved in the privatisation programme in Ghana. However, the crucial question remains to be answered whether the divestiture programme has so far met its set objectives at all. Again the future of the programme may have to be further evaluated in the light of current developments, particularly some political undercurrents following the change of government in January 2001. For example, the present New Patriotic Party (NPP) Government has already initiated moves to abrogate some divestiture sales contracted by the previous NDC Government, and among these, the abrogation of the management and consultancy contract with Telecom Malaysia (30 percent shareholders in Ghana Telecom) is notable. The concern of this researcher boarders on the question of what signals such hostile actions by government are likely to send to potential
investors. It is important that undue politicisation of the programme is avoided and more efforts directed at making already privatised firms viable and also to develop better linkages between the divestiture process and other important sectors of the economy, notably, the money and capital markets.

And adding this to the vast literature already examined in the previous chapters, we should now be in the position to draw some meaningful conclusions from this study.
CHAPTER 6

CONCLUSION AND RECOMMENDATIONS

In this chapter, we take a brief summary of our discussion on the concept of privatisation as covered in this study. This is followed by some policy suggestions and inferences drawn from the study. The major limitations of this study are presented, and suggestions for future research made.

Privatisation can be seen as an all-embracing term for several actions, all of which are directed at shifting activity from the public sector to the private sector. These ‘several actions’ have come to be accepted as the methods of privatisation, each of which is directed at some specific economic objective, among which efficiency improvement stands very tall. The primary objective of this thesis was to examine this all-embracing economic concept of privatisation with a view to develop an in-depth understanding of the process, but with a special focus on the privatisation programme of Ghana. To this end, efforts were directed at analysing in detail, the definitions and important economic theories underlying the concept of privatisation. Some arguments raised both against and in favour of privatisation were also discussed. Again, economic efficiency remains the pivot around which these arguments evolve, making it important for us to devote a chapter of this thesis to some empirical studies on the efficiency concept.

However, the issue of efficiency, we noted, cannot be contended in isolation. It is tightly hooked to the question of ownership, as privatisation basically
involves the transfer of ownership from the state to the private sector. We devoted some attention as well to the importance of ownership and its related implications for efficiency improvement in privatised firms. This led us to the role of market structure, the importance of competition, and its intricate intermarriage with the appropriate form of ownership to produce the desired level of efficiency. Some fundamental theories underlying the ownership-efficiency debate (agency, property rights, and public choice theories) were examined, and we saw arguments flow from all three theories that tend to favour private ownership, much more than public ownership. Finally empirical evidence was sought by examining some comparative studies on the impact of privatisation (ownership) on corporate performance. Though the studies are not altogether unequivocal in their findings, evidence on private sector superiority (in terms of efficiency and economic performance) remained much more overwhelming.

An attempt was made at exploring the growth and development of the public sector of Ghana. We examined the contributions of various governments since independence to the increase in the number of state-owned enterprises over the years. The reasons for setting up these SOEs, their contribution to the economy and their overall performance over the years was discussed, giving a vivid picture of the state of these SOEs before the Economic Recovery Programme (ERP).

The ERP was given considerable attention in this study because of its special implications for the privatisation programme. In the first place, the
privatisation programme came as an integral component of the recovery programme. Again as we have noted earlier in this study, the ERP/SAP injected a lot of changes into the economy including some observable discipline into the public sector even before the start of the privatisation process. The ERP/SAP further provided the appropriate environment for private sector participation in economic activity. The discussion on the ERP is also important because of the effects of structural changes on the performance of privatised firms. The argument has been that, given this new and improved environment, most SOEs may produce similar results as the privatised firms.

Finally, we brought the focus of our study to bear on the entire process of Ghana’s efforts at privatisation. We began by identifying the objectives for the programme and also took a look at the earlier preparations made towards the eventual take off. We examined in detail the divestiture programme itself with much emphasis on the procedures adopted, results achieved so far, as well as some observable problems that have caused undue delays in the process. A selected number of privatised firms that have for long been branded as the ‘success story’ of Ghana’s divestiture programme was briefly reviewed. The final section covered a brief assessment of the impact of the privatisation programme on the growth and development of the Ghana Stock Exchange as well as its impact on employment and its accompanying social implications.
Recommendations

The divestiture programme of Ghana has come a long way, having already covered a period of 12 years. However, the process has been very slow due to various problems already noted in this study, leaving several medium and large scale SOEs still in government hands with the concomitant drain on state coffers. Further delays in the sale of these enterprises, particularly those already in financial distress, would not only make the divestiture process more costly for government, but also reduce considerably, the efficiency gains expected from divestiture. The delay in divestiture can further be considered in terms of the opportunity cost of lost tax revenue, employment, and production, which could be quite substantial. It will be in the overall interest of government to accelerate the privatisation process, as part of its overall strategy for sustainable economic growth and poverty alleviation. In line with the above observation, there is an urgent call for the weaknesses in the administration of the divestiture programme to be addressed. Some of the possible measures to be taken in this direction include the following:

1. The composition of the Divestiture Implementation Committee may have to be reconstituted to allow for a larger representation of the private sector and other interested, but neutral parties. This would enhance the independence of the DIC and help expedite the decision making process of the DIC. There is also the need to curb the unnecessary bureaucracy that had characterised the operations of the DIC to date. The DIC Secretariat may have to be restructured to
resolve the weaknesses in its functioning that have impeded information flow and decision making. The current situation where most decisions could not be taken in the absence of the Executive Secretary of the Committee should be addressed.

2. Lack of transparency and the effective participation by major stakeholders have also largely hindered the smooth implementation of the divestiture programme. The accurate and timely dissemination of information on divestiture, and the involvement of various stakeholders at an early stage of the divestiture process, is a necessary step to curb this problem. Further, the conduct of the bidding process should be in the full knowledge of the stakeholders and the public at large, in order to enhance transparency and much needed accountability. It is expected that this approach will speed up the divestiture process by bringing to light potential questions, problems, and opposition to the programme.

3. Also to be considered is the current strategy followed in preparing enterprises for divestiture. Some avoidable delays have been encountered in the preparation of enterprises by the infusion of new investment and financial restructuring. Beside the delays, there is also a substantial financial loss for the government when the enterprise is eventually divested. These losses sometimes arise when the new investments or restructuring do not fit the interests of new owners, who may prefer a different approach to addressing the problems of the enterprises.
4. Just as privatisation can help develop capital markets, so can a vibrant capital market also help expedite the process of privatisation. It cannot be denied that, the divestiture programme has made some considerable impact on the growth and development of the Ghana Stock Exchange. However, there is still a lot of room for reciprocal impacts to be made. Government may have to consider its present emphasis on privatisation through strategic investor financing and channel more of its equity sales through the stock exchange. This will further enhance the role of the stock exchange in promoting capital market deepening. It will provide the general populace with an opportunity to participate actively in the privatisation programme in their own small way, and go a long way to broaden the support base of the privatisation programme.

5. There is also an urgent need for increased publicity particularly with regard to the post-divestiture performance of privatised enterprises. Current information on a few of such companies is very sketchy and still 2-3 years behind time. Also, the same old enterprises have been paraded for years as "success stories", giving the impression that the larger number of privatised firms may not be doing so well. Information that details an objective evaluation of all these firms would help remove the doubts in the minds of potential investors.
Limitations of this study and suggestions for future research.

The major problem encountered by this study is that of data unavailability. The divestiture programme in Ghana still appears to be in its teething stage with a key problem of record keeping and dissemination of information. Particularly, most privatised firms are unable to trace their pre-divestiture records and some did not even have financial statements prepared for several years before divestiture. Some privatised firms are also unwilling to give out any more information than their annual financial reports. Also, there is an obvious confusion between the State Enterprises Commission (SEC) and the SOEs as to who should organise and keep records for these enterprises. The potential researcher ends up being tossed to and fro between the SEC on one hand, and the SOEs on the other. This made any detailed comparison of post and pre divestiture performance virtually impossible. Available studies on public verses private sector performance so far (for example Bavon, 1998) mainly compare the performances of existing SOEs with those of existing private sector firms. This obviously does not give any credible evidence to the impact of privatisation on corporate performance.

Further research is highly recommended, that will be able to get around this problem, to ascertain the success or failure of the divestiture programme, by comparing pre and post divestiture performances of the enterprises involved. Such a study may also consider controlling for changes in the economic
environment (as a direct result of the Economic Recovery Programme) in order to ascertain the real effects of privatisation on economic performance.
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