OECD DEVELOPMENT CENTRE www.oecd.org/dev/insights

Policy Insights No. 14

Privatisation: A Challenge for Sub-Saharan Africa

by Lucia Wegner

This *Policy Insights* is derived from the special theme section of the 2003 *African Economic Outlook* and on a 2004 OECD Development Centre Study[1]

The Record So Far

Thirty-eight sub-Saharan African countries have implemented privatisation programmes, following the mid-1980s pattern in the OECD countries: privatisations of small and medium-sized enterprises in the early 1990s; and larger enterprises, including, companies in the utilities sector, by the mid-1990s.

There had been 2 535 privatisation transactions in sub-Saharan Africa by 2002. French-speaking countries (Côte d'Ivoire, Madagascar, Mali, Niger and Togo) were the first to carry them out, joined in the late 1980s, by some Portuguese and English-speaking countries (Mozambique, Nigeria and Ghana). The number of privatisations peaked at 495 in 1995. The total sale value for the region by the end of 2002 is estimated at $8.8 billion, against $46 billion in transition economies and $177 billion in Latin America and the Caribbean. Lower proceeds reflect the poor financial condition of the companies listed for privatisation.

Sales values differ substantially from the number of transactions. Early privatisations were numerous but yielded relatively little. Utilities and strategic sectors of the economy contained fewer candidates but, initially at least, brought higher proceeds. The spectacular peak in 1997 was caused by the sale of 30 per cent of South Africa's *Telkom* worth $1.26 billion.

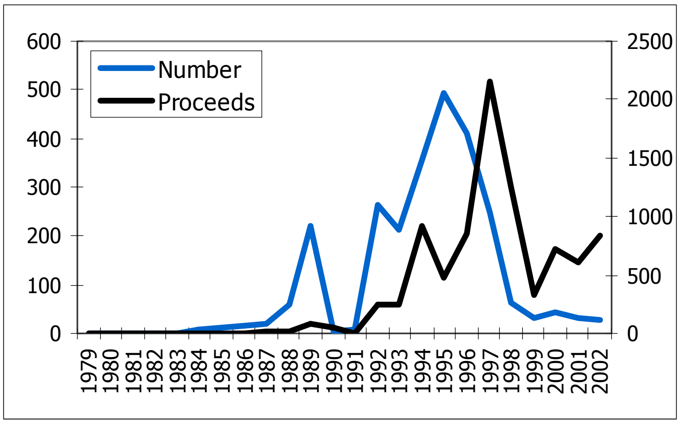
1. The results illustrated are based on Berthélemy, Jean-Claude, Céline Kauffmann, Marie-Anne Valfort and Lucia Wegner (2004), *Privatisation in Sub-Saharan Africa: Where Do We Stand?* OECD Development Centre Study; and on the *African Economic Outlook* report. www.oecd.org/dev/aeo

West and Southern Africa are the most dynamic zones in sub-Saharan Africa for the number of transactions and the value of sales. South African privatisations, however, are fewest but produce the highest proceeds in sub-Saharan Africa ($179.3 dollars per transaction), because the process has focused on large entities in transport, defence and telecommunications. Conversely, in the same region, Mozambique and Zambia rank first and second in the number of transactions in all sub-Saharan Africa, yet proceeds are relatively slim, respectively $0.7 and $2.8 per transaction because the sales involved small retail establishments and the dismantling of large non-core entities in the residential-housing sector.

Agriculture, extractive industry, manufacturing, construction, and tradable services accounted for 70 per cent of all privatisations up to the end of 2002, before attention turned to power, water, telecommunications and transport. Divestitures in the latter sectors have been delayed, despite their often being unproductive, inefficient and badly managed under public ownership, because utilities:

- provide both production inputs and services that are part of the consumption basket of households;
- are an essential tool of distributive policy making, since they can be used by politicians to support either progressive policies or, in contrast, clientelist objectives;
- display very specific features in terms of organisation (e.g. the possibility of economies of scale and important sunk costs) naturally leading to market concentration; and
- provide wage employment for an important urban workforce.

Figure 1. **Annual Number of Privatisations and Proceeds up to 2002**



Source: *Privatisation in Sub-Saharan Africa: Where Do We Stand?* OECD Development Centre Study, 2004.

A Limited Impact on Private Sector Development

Since the beginning of the process in 1990, the number of privatisations through public flotation has been only 4 per cent of total transactions. Moreover, the trend is downward, confirming the difficulty in African countries of building stock exchanges and capital markets, still often used by governments to raise loan finance rather than capital for industry.

Some countries have attempted to give priority to local investors. In Ghana, for instance, where restrictions on non-resident portfolio investors apply, and in South Africa with special offers for historically disadvantaged individuals. However, the participation of the local private sector is also constrained by poor management and the lack of access to cheap financing. Only Mauritius has attempted to create small and medium-sized entities in the power sector. There, close to 25 per cent of annual electricity generation comes from local privately owned and operated cogeneration plants in the sugar industry.

The Efficiency and Labour Market Impact Have Varied Across Sectors

In the competitive manufacturing and tradable services sectors, efficiency gains, defined as improved performance of the company, have been generally achieved with wide variations in performance across firms and countries. The same is less true for the utilities sector, with the exception of telecommunications where spectacular gains have been recorded because of the quasi parallel introduction of GSM competition. After the 1997 privatisation of restructured *CI- Télécom* in Côte d'Ivoire, three cellular operators entered in the market. Between 2001 and 2004 operating costs per line decreased by almost 50 per cent, and turnover rose by 70 per cent.

The counterpart of the gains in efficiency and much of the reason for opposition to privatisation is the fear of massive lay-offs. The evidence, however, is less clear. The competitive sectors generally experienced a significant decrease of employment in the year of privatisation, which was then followed by a stable period and an upward trend in the two years following the launch of a privatisation plan. Examples of this pattern occurred in Tanzania and Mozambique. In public utilities, however, large-scale lay-offs have been widespread as the combination of considerable overstaffing and insufficient training seriously limited efficiency. Consequently, job redundancies have been particularly severe in the power sector, while water mostly remained under strong public control.

To soften the impact on employment, under public opinion pressure, some national authorities have become more attentive to job preservation during the privatisation process. In Zambia and Burkina Faso, for instance, the retention of existing staff became an explicit criterion with which private investors had to comply. In the case of the privatised water company of Guinea, employees have been redeployed in subcontractor companies[2]. As a cushion against the negative social impact of job redundancies, some Southern African governments have negotiated severance packages in co-operation with companies and trade unions.

Has Privatisation Benefited the Poor?

Privatisation is often considered detrimental to the poor because it entails the elimination of subsidies and therefore the increase in prices of products and services needed by the poor, such as water, electricity and public transportation.

Nevertheless, countries' experience shows that not all subsidies applied under public ownership reduce poverty, often because the beneficiaries are the richest groups. Public enterprises have been used to secure rents for relatively small clienteles, offering above-market wages or under-pricing. In urban areas of Ethiopia in 1996, some 86 per cent of subsidies on kerosene were captured by the non-poor, since kerosene consumption increases with income. Even when significant rates of subsidies are applied on the official market, many poor people are forced to buy fromsecondary markets (due to lack of legal access), and low official prices are also enjoyed by the rich.

2. The Guinean privatised water management company SEEG helped its approximately 250 laid-off workers to establish co-operatives to provide services such as new connections, canal maintenance and landscaping. Overall, about 20 small enterprises were founded, all of which are subcontracting for SEEG.

The evidence shows that privatisation has affected prices in two different ways. On the one hand, in the telecom sector, increased competition, with the granting of additional mobile or fixed line licences, has generally pushed prices downwards. On the other hand, privatisation in power and water has typically led to higher tariffs. Since it had been common practice to subsidise electricity and water tariffs, many holders of concession and lease agreements have had to re-adjust tariffs to cost-recovery levels following acquisition. In many cases (e.g. Uganda, Zimbabwe and Zambia), tariffs were raised before privatisation to reduce the companies' financing gap and to attract strategic buyers.

There are, however, exceptions. The 1997 concession of *Société d'Energie et d'Eau du Gabon* (SEEG), led to cheaper electricity and water services. A well-designed concession contract that clearly specified the quality and coverage targets and a decade-long preparatory restructuring phase were responsible.

Proper Regulation Is Crucial to Ensure Welfare Gains

The effects of privatisation on living conditions of the population, and, in particular, on improved access and quality, are mixed and depend on the regulatory framework in place and the capacity of the state to co-operate with the private sector. In particular, the impact of privatisation policies on the welfare of the population and ultimately on the poor requires:

- strong commitment and ownership by the state to ensure the credibility of the reform to the private investor;
- proper sequencing of the process, including: a restructuring phase and the appointment of a regulatory body prior to the divesture;
- independent and well-enforced regulation to discipline the private sector and provide the appropriate incentives to undertake investments (e.g. extension network).

The 1990 privatisation of the *Compagnie Ivorienne d'Electricité (CIE)* with strong political commitment, good co-ordination between the government and private sector, and an appropriate regulatory framework led to the success: improved access, expansion of generation capacity, and increased revenue for the state. Similarly, the privatisation of *Sonatel* in Senegal was successful due to the early establishment of a regulatory body and a long preparatory restructuring phase of the company before the sell off.

Conversely, in countries lacking proper regulation, despite the presence of competition, profit-maximising behaviour has led privatised companies to keep investments below the necessary levels, with the result that rural communities and the urban poor were further marginalised. The 1997 experience of Ghana *Telecom* is an example. The contractor, *Telekom Malaysia,* failed to respect its undertaking to extend lines because the National Communication Authority (NCA) was too weak.

The privatisation of *Sonel* (Electricity Company) in Cameroon is another example of failure which reflects the absence of a proper sequencing of the process.

Privatisation does not thus imply the withdrawal of the state, but, requires strong institutional capacity to ensure that the privatisation contract is binding on the private investor and enforceable. For instance, specific targets for electrification of rural communities and poor urban neighbourhoods could be included in the licences of concessionaires and private power distributors, making the license renewal conditional to the minimum requirement.

Lessons Learned

The privatisation process in Africa is still far from complete and has led to mixed results. The successful cases of the *Compagnie Ivorienne d'Electricité, Sonatel*, and *Société d'Energie et d'Eau du Gabon* can not hide the dramatic failures. Most privatisations have been imposed from the Bretton Woods Institutions – sometimes without taking into consideration the country's specificities – and suffered therefore from a lack of government commitment, which, in turn, led to significant opposition by the population and difficult implementation.

Nonetheless, the lessons learned from past privatisations allow the identification of elements that could contribute to future success.

- Privatisation should be integrated into other public policies, in particular to the country's Poverty Reduction Strategy Paper.
- Privatisation processes should follow proper sequencing, involving the setting up of well enforced regulation prior to the divesting phase.
- Privatisation processes should be adapted to the specific needs of each sector.
- Privatisation reform should involve a constant dialogue between the different actors engaged (citizens, state, private sector, and trade unions) in the process, in order to increase the awareness of the population, broaden local participation, built support and foster the state's accountability.

OECD Development Centre *Policy Insights*

No. 13 *MDGs, Taxpayers and Aid Effectiveness* by Ida Mc Donnell and Henri-Bernard Solignac Lecomte

No. 12 *The International Aid System: A Question of Perspective* by Felix Zimmermann

No. 11 *Private Health Insurance for the Poor in Developing Countries* by Denis Drechsler and Johannes Jütting

No. 10 *The Human Dynamics of Aid* by Malcolm MacLachlan and Stuart C. Carr

No. 9 *Adaptive Capacity and Inclusive Development* by Ulrich Hiemenz

No. 8 *Energy and Poverty in Africa* by Céline Kauffmann

No. 7 *Financing SMEs in Africa* by Céline Kauffmann

No. 6 *African Economic Performance in 2004: A Promise of Things to Come?* by Nicolas Pinaud and Lucia Wegner

No. 5 *Decentralisation and Poverty Reduction* by Johannes Jütting, Elena Corsi and Albrecht Stockmayer

No. 4 *Policy Coherence of OECD Countries Matters: Evidence from East Asia* by Kiichiro Fukasaku and Alexandra Trzeciak-Duval

No. 3 *Corporate Governance: A Development Challenge* by Charles Oman and Daniel Blume

No. 2 *Mobilising Public Opinion against Global Poverty* by Jude Fransman and Henri-Bernard Solignac Lecomte

No. 1 *Towards an East Asia Free Trade Area* by Shujiro Urata

Development Centre *Policy Insights*
www.oecd.org/dev/insights

Development Centre *Policy Briefs*
www.oecd.org/dev/briefs

Development Centre *Working Papers*
www.oecd.org/dev/wp

OECD

OECD Development Centre
2, rue André-Pascal,
75775 Paris Cedex 16, France
Tel.: +33-(0)1 45.24.82.00
Fax: +33-(0)1 44 30 61 49

E-mail: dev.contact@oecd.org