

**THE POLITICS OF PARASTATAL
REFORM AND PRIVATIZATION IN
KENYA**

BY

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DEDICATION

TO MY PARENTS
DAVID AND RHODA NJEREMANI

DECLARATION

I certify that this project is my original work and has not been presented for a degree in any other University.



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This project has been submitted for examination with my approval as University Supervisor.



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ABSTRACT

The study focuses on the role and impact of politics on divestiture. Specifically, it examines the legislative and institutional frameworks of public enterprises and privatization and the Kenyan experience in divestiture. The study assesses the following main question within a political context: how has divestiture been carried out in Kenya and what have been the results?

The study relied on data from publications, journals, policy papers, annual reports and oral interviews given to individuals who have been involved in the divestiture process. The study finds that the current legislative and institutional framework for public enterprises and privatization is weak. The absence of a privatization law, lack of ownership of the process, administrative hurdles, and ethnic and partisan interests has contributed to the weaknesses in the divestiture process. The study concludes that divestiture is an economic necessity for Kenya.

The study recommends the establishment of a privatization law, and the extensive education on the benefits of divestiture to create a sense of ownership of the process. The removal of administrative hurdles as well as corruption in the form of ethnic and partisan interests in the process would also reduce opportunities for interference in the process.

LIST OF ABBREVIATIONS AND ACRONYMS

CMA	:	Capital Market Authority
DFIs	:	Development Finance Institutions
DGIPE	:	Department of Government Investment and Public Enterprises
EAC	:	East African Community
ESTU	:	Executive Secretariat and Technical Unit
GoK	:	Government of Kenya
ICDC	:	Industrial Commercial Development Corporation
IDB	:	Industrial Development Bank
Kenya Re	:	Kenya Reinsurance Corporation Ltd
KTDA	:	Kenya Tea Development Authority
KTDC	:	Kenya Tourist Development Corporation
MoF	:	Ministry of Finance
NSE	:	Nairobi Stock Exchange
PERP	:	Public Enterprise Reform Programme
PEs	:	Public Enterprises
PFPs	:	Policy Framework Papers
PITs	:	Privatization Implementation Teams
PRPC	:	Parastatal Reform Programme Committee
SAPs	:	Structural Adjustment Programs

SOEs : State Owned Enterprises

Telkom Kenya : Kenya Post and Telecommunications Corporation

ANNEXURE 1

[The following text is extremely faint and illegible due to low contrast and blurring. It appears to be a list of items or a table of contents.]

CHAPTER ONE

1.0 INTRODUCTION

This study assesses the divestiture process in Kenya within a political framework. Privatization simply put is the process of transfer of activity from the public sector to the private sector. Divestiture encompasses parastatal reforms on one end and privatization on the other extreme end. It involves a wide range of policies to effect this transfer thus the government is very instrumental in this process. Politics is experienced in privatization in the area of decision-making. Without political commitment, privatization is unlikely to work. Privatization involves reducing the role of the state in public enterprises, partially or fully, and this may be faced with a lot of resistance from governments.

Agencies on which African countries depend heavily for external support, such as the World Bank and USAID, strongly push for the privatization of public enterprises. These pressures are seen, for example, in most International Monetary Fund and World Bank adjustment loans, which contain agreements to restrain the public budget¹. Since many public enterprises depend on budget support, the curtailing of such support inhibits further public enterprise

¹ Zulu, J. and S. Nsouli. [1985]. *Adjustment Programs in Africa*. Washington, D.C: International Monetary Fund, April in Grosh, Barbara. [1991]. *Public enterprise in Kenya: What works, What doesn't, and Why*. Boulder, Colorado: Lynne Rienner Publishers, Inc. p 9

investment². Some structural adjustment loans have even carried explicit agreements to privatize public enterprises³. Many African policymakers resist the demand for privatization and focus instead on how to bring existing public enterprises under control. Their efforts have concentrated on tightening the control the government exercises over public enterprise managers.

This study focuses on privatization and parastatal reform and in particular the role played by politics in privatization. The main questions this study seeks to answer are as follows: What are the vested political interests the government has in parastatals? Is privatization necessary or is it merely a political necessity?

1.1 BACKGROUND

Until the 1990s, government domination of production, trade, prices, and all areas of economic activity characterized economic management in Africa. These economic policies and programs led to over expansion of the public sector, erosion of incentives of industry and agriculture, and overprotection of industry⁴.

² Barad, Robert [1988]. *Structural Adjustment, Privatization and the Industrial Sector: Lessons from Recent Experience in the Republic of Togo*. Masters' Thesis, American University pp 39-40 in Grosh Barbara. [1991] *Op cit* p9

³ Killick, Tony, and Simon Commander. "State Divestiture as a Policy Instrument in Developing Countries." *World Development*, 16 no. 12 [1988] p 1467 in Grosh Barbara [1991]. *Op cit* p 9.

⁴ Wallace, Laura [Ed]. [1999]. *Africa: Adjusting to the challenges of globalization*. Washington: International Monetary Fund. p 186

After independence, Kenya opted for a mixed economy, which allowed for ownership of property and enterprise by both the state and private sectors. This policy, contained in Sessional Paper no. 10 of 1965, advocated for a strong public sector with government ownership and control of key enterprises, especially in energy, transportation, communication, banking, insurance and manufacturing. Institutional arrangements were in place to govern procurement, processing and the movement and marketing of agricultural commodities, including maize, wheat, other cereals, sugar, dairy, meat products, cotton, pyrethrum – the latter two being marketed by state or quasi-state monopolies. There were also regulatory authorities created to monitor and supervise production, procurement, processing and marketing of dairy products, pyrethrum, sisal, tea and coffee. Also, after independence, new corporations were created to promote activities in manufacturing, commerce and tourism. State – or quasi-state-owned corporations were created to implement the import-substituting industrialization policy that was in place then. The pressures on balance of payments and domestic prices – brought about by the 1973-74 oil crisis – gave rise to more controls. Parastatals, especially in the manufacturing sector, were awarded more protection, including monopoly or quasi-monopoly status. After pressure on balance of payments, general price levels and the budget intensified after the ~~second~~ oil shock in 1979, the government accepted that reform was clearly in order⁵.

⁵ Mule Harris. "Lessons on regulatory Reform: Kenya's Experience" in Wallace, Laura. *Op cit* Pp27-29

Kenya began implementing economic reform programs to reverse the socio-economic decline that had beset it since the 1970s. In 1982, the government appointed a working party on public expenditure whose report revealed that the growing gap between government revenue and expenditure was largely due to state involvement in commercial activities and the provision of services at subsidized rates. Later on, a parastatal reform program was put in place under which the government listed 33 strategic parastatals to be restructured and retained in the public domain and 207 non-strategic parastatals to be privatized⁶.

The comprehensive economic memorandum for Kenya, *Stabilization and Adjustment: Toward Accelerated Growth*, issued in October 1990 argued that Kenya could and needed to develop and grow more quickly. However, the public sector had not faced the need for comprehensive structural adjustment, although this was critical for faster development. The ensuing report acknowledged that although privatization should be an important component of a parastatal reform program, it should be viewed as part of a broader effort to promote production efficiency, strengthen competitive forces in the economy, and support entrepreneurial development. The report, *Re-Investing in Stabilization and Growth Through Public Sector Adjustment*, emphasized the need for comprehensive parastatal reform arguing that the sectoral adjustment measures, which helped the economy to raise its growth performance over the last five

⁶ Gatheru, W and R. Shaw [Eds] [1998]. *Our Problems Our Solutions: An Economic and Public Policy Agenda for Kenya*. Institute of Economic Affairs. Pp33-45

years [1986-1990] were being undermined by destabilizing fiscal imbalances and the deteriorating productivity of the public sector. One of the recommendations was that parastatal reform program should embrace not only divestiture which is implemented in a transparent way, but also regulatory, and the restructuring of strategic enterprises which were expected to remain in the public sector⁷.

Since the 1990s, privatization has been one of the reform processes taking place in Kenya to improve its economy. Kenya relied a lot on state-owned enterprises in the hope that they would balance or replace a weak private sector⁸.

According to the Investment Promotion Center, the government has disposed off 136 parastatals as follows:

Liquidation	26
Through pre-emptive rights	53
Through receivership	19
Voluntary liquidation	14
Through public floatation	10
Through competitive bidding	16
Partial Divestitures	12

Source: Investment Promotion Center [1998]

⁷ World Bank. [1992]. *Kenya: Re-Investing in Stabilization and Growth Through Public Sector Adjustment*. The Main Report. Vol 1. January, 10 p vi

⁸ Kikieri et al. [1994]. *Privatization: Lessons from Market Economies*. The World Bank Research Observer. Vol 9, No. 2. pp25-27

The policies governing privatization in Kenya are set out in the *Policy Paper on Public Enterprises and Reform and Privatization*. The principle of the policy is the promise that all transactions will be conducted in an open and transparent manner, consistent with normal standards of commercial discretion. Privatization has been undertaken in various state-owned enterprises for example, Kenya Airways, with the government holding 23 percent of the shares, 60 percent in the Kenya Commercial Bank and a reduction of 20 percent of government held shares in the National Bank. However, other entities such as the National Cereals and Produce Board (NCPB), the National Hospital Insurance Fund (NHIF) and the National Social Security Fund (NSSF) have not been privatized. The new bill that replaced the *Electric Power Act* on 9th January 1998, aimed at liberalizing the energy sector so that the private sector could take part in the generation of power and its sale to the grid⁹.

By the early 1990s, Kenya's economic situation had worsened. Economic growth fell from 4.4 percent in 1990 to 0.4 percent in 1992, inflation accelerated and external payments arrears emerged. By March 1993, inflation rose to 58 percent on an annual basis in the first quarter of 1993¹⁰.

⁹ Gatheru, W and R. Shaw [Eds]. *Op cit* pp33-45

¹⁰ IMF Annual Report. [1994] pp 64-65

In December 1993, the International Monetary Fund [IMF] Directors completed the Article IV consultation with Kenya and approved its request for a loan equivalent to Special Drawing Rights [SDR] 45.23 million under the Enhanced Structural Adjustment Facility [ESAF] in support of the Government's economic and financial program covering October 1992 – September 1994. Directors underscored that a key component of the adjustment strategy was to reduce the government budget deficit, primarily through cuts in expenditure in relation to GDP. Privatization of certain functions being carried out by the Government was recommended as one of the steps in improving the quality of expenditure. Also recommended to be phased out was the direct or indirect subsidies and payments to public enterprises¹¹.

By 1992 and 1993, Kenya was experiencing severe external imbalances and budget deficit crises. In response to the crisis, and with prodding from the IMF and World Bank, the government undertook far-reaching economic reforms in 1993, most of which had either been withheld or only partially implemented in the 1980s, now being adopted fully. The reforms included repealing laws and regulations confirming monopoly status to state enterprises, strengthening of laws to curb monopoly practices and setting in motion measures to privatize non-strategic state enterprises¹².

¹¹ Ibid

¹² Mule Harris. *Op cit* pp30

Initiatives to improve governance, which have been important components of Kenya's structural adjustment programs and Public Sector Reform programs supported by the IMF and World Bank, were implemented. The reforms included parastatal sector reforms and privatization. Other initiatives taken were enhancement of accountability and transparency, strengthening oversight and control institutions, improving public expenditure management and liberating the private sector to drive the economy¹³.

1.2 STATEMENT OF THE PROBLEM

The government has taken measures to create an enabling environment for divestiture and has taken steps in the process to ensure economic efficiency and growth. Privatization is a commercial and economic process as well as a political one. However, what is the extent to which one can claim that the political impact on privatization has been given adequate attention as the commercial and economic one? The question this study examines is how divestiture has been carried out by the Kenyan Government within the political framework and with what results.

¹³ Kenya, Government of: National Governance Programmes and Initiatives, December 2001 in *Kenya: 2001 Article IV Consultation – Staff Report; Staff Supplement; and Public Information Notice on Executive Board Discussion* IMF [2000] p 2

1.3 OBJECTIVES OF THE STUDY

The broad objective of the study is to examine the politics of PE reforms and privatization in Kenya.

Specific Objectives

- To critically examine the legislative and institutional framework of public enterprises in Kenya and how they have affected the privatization process.
- To examine the Kenyan experience in divestiture and consequently establish the impact of politics on the divestiture process.

1.4 JUSTIFICATION OF STUDY

Studies that have been carried on privatization are limited by the focus of study for example Wallace¹⁴, Chu Ke-young and Hemming¹⁵, and Vito Tanzi¹⁶. Other studies such as that of Grosh¹⁷ are limited by the period. Insufficient information is therefore available to show the dimensions of privatization especially with respect to politics. The impact of politics on divestiture has not been given adequate attention. This study hopes to provide the missing information for one important case – Kenya. On the policy front, the study acknowledges the importance of politics in divestiture in the establishment of policies by policy makers. This study therefore establishes the role of politics in the divestiture process.

¹⁴ Wallace, Laura [1991]. *Op cit* pp107-112, 169-172

¹⁵ Chu Ke-young and Hemming [1991]. *Op cit* pp142-144

¹⁶ Tanzi, Vito [1992]. *Op cit* pp94-97

¹⁷ Grosh, Barbara [1991]. *Op cit* p166

1.5 LITERATURE REVIEW

In Western Europe, countries with a tradition of strong institutions, rule of law, and judicial accountability have generally engendered transparent privatization processes. A number of Latin American countries in the 1990s have had a reasonably transparent privatization process. This has been because privatization has been part of a comprehensive change in regime, institution building, and reorientation of the economy toward the market. However, where there has been limited oversight from other branches of government, corrupt practices associated with privatization have been reported¹⁸. In the case of Russia, for example, strong and well-organized interest groups have tended to "hijack" the privatization process to their advantage. This is where the institutional framework and rule of law have been weak¹⁹.

The legal framework for Poland was established in June 1990, with the passing of the Privatization Law. By the end of the year, a provisional program was outlined [Government of the Republic of Poland [1990]]. Reflecting the strengths and weaknesses of the available options, the proposed program was somewhat eclectic in character. It had four aspects: enterprise commercialization; mass privatization; direct sale of some large enterprises; and

¹⁸Manzetti, Luigi [1998] "Are Market Reforms Ending Corruption in Latin America?" *Mondes en developpement*. Vol. 26, pp 69-81 in Davis, Jeffery, Roland Ossowski, Thomas Richardson, and Steven Barnett [2000]. *Fiscal and macroeconomic impact of privatization*. Washington: International Monetary Fund p34

¹⁹Aslund, Anders [1999] "Why has Russia's Economic Transformation Been So Arduous?" paper prepared for the Annual World Bank Conference on development Economics. Washington, April in Davis, Jeffery, Roland Ossowski, Thomas Richardson, and Steven Barnett [2000]. *Op cit* p34

the privatization of small – and medium – sized enterprises²⁰. Poland intended to privatize about a half of state industry, which dominated the economy, in as little as three years.

Political commitment was evident but institutional obstacles were immense. There were no capital markets, administrative capacity was weak, and the legal infrastructure hardly recognized private property, price distortions made valuation difficult, and domestic savings were a small fraction of enterprise worth. A combination of every available privatization technique was adopted, which included mass privatization based upon the free disposal of shares to the population. Privatization was also supported by wide-ranging price and trade liberalization, appropriate competition policy, and fiscal and monetary reform²¹.

The cornerstone of privatization in Czechoslovakia was the voucher scheme. Between 40 percent and 80 percent of the equity in 1000 – 2000 of the largest enterprises were to be distributed through vouchers. Vouchers were not issued to all citizens, but were instead to be sold for a nominal sum. This was done in the hope that voucher holders would take interest in the privatization process and the performance of the enterprise that they would ultimately own. The state would retain a minority shareholding in many large enterprises. Other forms

²⁰ Hemming, Richard. "Privatization of State Enterprises" in Tanzi, Vito [Ed] [1992]. *Fiscal Policies in Economies in Transition*. Washington: International Monetary Fund p94

supplemented the voucher scheme. There was substantial progress with small – scale privatization through auctions of shops, restaurants, and other businesses in the service sector²².

Privatization in Hungary begun in late 1988, with the passing of legislation allowing enterprises to be transformed into joint stock companies as a prelude to privatization. There followed a flood of spontaneous privatization, as the management of many enterprises exploited opportunities to take them over or to enter onto lucrative deals with foreign partners. To prevent the privatization process from falling into further disrepute, the direction of policy was shifted. By mid – 1989, spontaneous privatization was under control, and a government – led strategy was being put into place²³. A new State Property Agency [SPA] was set up in 1990 to oversee the privatization process. The program emphasized the sale of enterprises, with a view of using the proceeds to reduce debt, avoiding the use of vouchers. Privatization was to proceed through three main avenues: small shops and restaurants were to be auctioned in 1991; two programs for selling large enterprises were launched during 1990. Hungarians also adopted a liberal attitude to foreign participation in the privatization process. There were special incentives for foreign investors and state assets were

²¹ Hemming Richard and Kenneth Miranda. "Privatization" in Chu Ke-young and Richard Hemming [Eds] [1991]. *Public Expenditure Handbook: A guide to Public Policy Issues in Developing Countries*.

Washington: International Monetary Fund p143

²² Hemming, Richard in Tanzi, Vito [1992]. *Op cit* p96

²³ Schwartz, Gerd [1991]. "Privatization: Possible Lessons from the Hungarian Case". *World Development*, 19 in Hemming, Richard in Tanzi, Vito [1992] *Op cit* pp96-97

disposed of free of charge only to public agencies, such as social insurance funds, but with a corresponding reduction in subsidies.

Thailand used an alternative form of privatization; franchising. The Bangkok Metropolitan Mass Transit Organization [BMMTO] began franchising bus routes in the late 1970s. Results were mostly positive, with BMMTO increasing the number of buses on crowded routes and selling off many of its used buses at attractive prices. However, some evidence exists that the franchises were underpriced, and that the BMMTO did not maximize its financial gain²⁴.

In Australia, in an effort to improve road sealing, town sweeping, and other activities at the city council level, the government decided to contract out these various functions. Contract specifications and conditions with built-in safety clauses to maintain the quality of service were developed. Regular review procedures and monitoring systems were introduced. Competitive tendering resulted in a reduction in costs and an improvement in services offered²⁵.

For a long time, vast expanses of the Mozambique economy were controlled by state-owned enterprises. Massive privatization has taken place over the years, with an adoption of an outward orientation on policies. Significant steps have been taken to promote macroeconomic stability and fiscal policies have been

²⁴ Hemming, Richard and Kenneth Miranda. *Op cit* p144

²⁵ Ibid.

tightened to ensure that the government is not a source of economic instability. In 1995, inflation was averaging 50 percent a year but by 1998 inflation was in the low single digits, and real growth of GDP was consistently in the range of 7-8 percent. Of importance was the minimizing of the government's interference in the privatization process. The trick lied in the knowledge of the government on when liberalization required new and different regulations.

Mozambique, however, has to work on institutional reform especially in terms of policy implementation and public administration. It would take concerted effort over a period of years to improve the operation of the public service and to mold the laws and regulations into shapes that can be implemented by their own public service²⁶.

Uganda embarked on a capacity building plan and on good governance in order to achieve economic growth. Capacity building entailed training and development of human resources as well as improving the system and institutional structures. In 1994, Uganda's Capacity Building Plan was published with the objectives of building Ugandan ownership of the capacity building process, identifying the areas that needed priority attention, developing an overall institutional framework to implement the plan and to guide donors in their financial and technical assistance contributions. In the spirit of good

²⁶ Salomao, Tomaz. Panel Discussion paper in Wallace, Laura *Op cit* p 169-172

governance, Uganda drafted a new constitution, which codified among other things, the decentralization of government to ensure that the people had control of the decision-making process and allocation of resources. The spirit of better governance is also woven in Uganda's economic reform program. The program aims at opening up and liberalizing the economy, and increasing competition, which, among other things, eliminates the opportunities for rent seeking. Privatization of state-owned enterprises was one way of doing this. Uganda recognized the importance of increasing the transparency of the interface between the public officials and the private sector, leveling the playing field for all private sector participants and reducing to the bare minimum the discretion allowed to government officials in the decision-making process. This was all in the effort of making the privatization process a success²⁷.

Past employment in Ghana led to significant overstaffing in the public enterprise sector. At the same time, collective bargaining agreements granted extremely generous severance pay arrangements. In an attempt to maximize proceeds from the eventual sales, pre-privatization efforts focused on rationalizing manpower levels at many of the firms to be divested. However, on the absence of political will or desire to repudiate past ill-conceived policies, part of Ghana's privatization program was hindered and delayed by a lack of budgetary resources

²⁷ Tumusiime, Emmanuel. "Better Public Sector Resource Management" in Wallace, Laura *Op.cit* p107-112

to cover the contingent liabilities of the firms to be divested, and in particular severance pay²⁸.

In the case of Sierra Leone, members of the civil administration were the most interested prospective buyers of assets under a World Bank coordinated privatization program. Because of limits of foreign ownership as well as a weak private sector and poor financial intermediation, it appeared that the government might have ended up receiving less than a fair price for privatization enterprises. The government had then to restructure the privatization program, with a view of raising the income the government derived from privatization and improved the government's fiscal position²⁹.

The above literature on privatization is limited to the extent that the political context of privatization is not adequately portrayed. As Paul Samuel³⁰ puts it, institutional analysis by the World Bank is focused on the technical aspects of service delivery and of institutions. The impact of interest groups on the workings of the institutions, the likely resistance to reforms from political or bureaucratic fronts and an assessment of the risks involved in the proposed reforms seem to have been neglected. Cheserem Micah³¹ is of the opinion that proponents of economic reforms, such as the IMF, should also be actively

²⁸ Hemming, Richard and Kenneth, Miranda. *Op cit* p144

²⁹ Ibid.

involved in political reform. From past experience, emphasis on economic reform alone has led to only partial success of the reform efforts.

After a research on public enterprises in Kenya, from independence in 1963 until 1988, Barbara Grosh³² came up with the following conclusion. Privatization will not rescue Africa from the public enterprise problem. To improve efficiency and profitability, it would be more effective to begin with detailed sectoral reforms of the small number of firms that constitute the bulk of "the public enterprise problem". For privatization to result in greater efficiency and profitability, it may be necessary to address the parastatal's failure, either directly or indirectly. The performance improvement should be the result of policy reform, rather than privatization *per se*. Policy reform might be possible without privatization, but because of the politics surrounding political functions of parastatals, privatization may be a political necessity to permit the cutting off of social roles previously performed.

Different models of state activity have been formulated to change the role of the state in public enterprise running and not necessarily to reduce it. The Nordic social market model, for example, includes a strong and unencumbered private

³⁰ Paul, Samuel [1989]. *Institutional Reforms in Sector Adjustment Operations*. Washington: World Bank [March] Mimeo in White, Louise G [1990]. *Implementing policy reforms in LDCs*. Colorado: Lynne Rienner Publishers p24

³¹ Cheserem, Micah. Panel discussion in Wallace, Laura [1991] *Op cit* p186

³² Grosh, Barbara [1991]. *Op cit* p166

sector with state responsibility for developing human resources and providing safety nets³³.

Each country experience on privatization is unique in its own way, but one thing is clear in each experience. Where there was great commitment shown by the government towards the privatization process, sacrifices were made to ensure the success of the process, for example in Poland and Uganda. Hemming and Miranda³⁴ believe that any constraint to privatization can be overcome by political commitment without which privatization is unlikely to occur. Louise White³⁵ also shares the same sentiments and adds that strong state support is needed to make the privatization reform process work.

1.6 CONCEPTUAL FRAMEWORK

There is substantial and growing microeconomic literature that strongly supports the notion that private firms are operationally more efficient than those held by the state. This conclusion holds for firms in competitive industries and for enterprises in less competitive settings as well, although in the latter the conclusions may be drawn less sharply³⁶. A wide range of studies of firm-level

³³ Mitra, Radja [1989]. *The Social Market Economy Paradigm: Lessons from the Early Nordic Development Experience*. Washington, D.C.: World Bank, Special Economic Office. Mimeo in White, Louise G [1990] *Op cit* p27

³⁴ Hemming, Richard and Kenneth Miranda. "Privatization" in Chu Ke-young and Richard Hemming [1991] *Op cit* p142

³⁵ White, Louise [1990] *Op cit* p27

³⁶ Megginson, William L., and Jeffery M. Netter [1999]. "From State to Market: A Survey of Empirical Studies on Privatization", draft paper prepared for joint conference of SBF Bourse de Paris and the New

performance in both developing countries supports this result, as does a recent survey of evidence for transition economies. The literature on growth in developing and transitional countries suggest that policy variables – particularly fiscal discipline, price and trade liberalization, deregulation, and privatization and the clarification and protection of property rights – are extremely important in determining a country's growth performance³⁷. Aziz and Wescott³⁸ argue that taken individually these policy variables may have only a limited effect on growth, while conjointly they are strongly associated with rapid expansion of economic activity. Sal-i-Martin³⁹ agrees with his argument saying that while growth tended to be more rapid where the share of the private sector in GDP was higher, a number of the structural measures noted tend to substitute for one another as predictors of growth, similarly results have been found in explaining growth in transition economies⁴⁰. Privatization would be most efficient if institution building and the establishment of an appropriate regulatory framework and the rule of law preceded it. If the institutional underpinnings are missing but

York Stock Exchange, Paris in Davis, Jeffery, Rolando Ossowski, Thomas Richardson, and Steve Barnett. [2000] *Op cit* p 23

³⁷ Havrylyshyn, Oleh, and Donald McGettigan [1999]. "Privatization in transition countries: A sampling of the Literature." IMF Working Paper 99/6. Washington: International Monetary Fund in Davis, Jeffery, Rolando Ossowski, Thomas Richardson, and Steve Barnett. [2000] *Op cit* p 23

³⁸ Aziz, Jahangir, and Robert F. Wescott [1997]. "Policy Complementaries and the Washington Consensus". IMF Working paper 97/118. Washington: International Monetary Fund in Davis, Jeffery, Rolando Ossowski, Thomas Richardson, and Steve Barnett. [2000] *Op cit* p 23

³⁹ Sala-i-Martin, Xavier [1997]. "I Just Ran Four Million Regressions". NBER Working Paper 6252. Cambridge, Massachussets: National Bureau of Economic Research in Davis, Jeffery, Rolando Ossowski, Thomas Richardson, and Steve Barnett [2000]. *Op cit* p 23

⁴⁰ Havrylyshyn, Oleh, Ivailo Izvorski, and Ron van Rooden [1998]. "Recovery and Growth in Transition Economies 1990-97: A Stylized Regression Analysis." IMF Working Paper 98/141. Washington: International Monetary Fund in Davis, Jeffery, Rolando Ossowski, Thomas Richardson, and Steven Barnett [2000]. *Op cit* p23

the government is making progress towards establishing them, delaying privatization until they bear fruit may be a desirable strategy⁴¹.

Proponents of privatization argue that productive inefficiencies arising from public ownership and management can be reduced by privatization. This is because firstly, privatization limits the scope for political interference resulting in higher-quality managerial decision-making. Secondly, multiple public sector objectives, which reduce the ability of managers to minimize costs, will be reduced. Thirdly, the discipline of private financial markets, which lead to more rational managerial decisions, is imposed by privatization. Fourthly, by making managers to profit-seeking shareholders rather than to civil servants, privatization may improve managerial incentives.

Privatization may indeed improve productive efficiency under certain circumstances, but this need not be the case universally and privatization may not necessarily be the best method of securing such improvements. For example, creating political structures that discourage interference can reduce political interference, and profit maximization for multiple objectives can still be achieved without privatization. However, the central issue is whether the non-economic objectives pursued by the government are compelling. Certainly some simplification of goals will often be desirable and feasible. But it is inevitable that

⁴¹ Nellis, John R [1999]. "Time to Rethink Privatization in Transition Economies?" *Finance and Development*, Vol.38 [June], pp16-19 in Davis, Jeffery, Rolando Ossowski, Thomas Richardson, and

efficiency will have to be judged relative to objectives that are wider than those in the private sector. Greater financial disciplines can be imposed on public agencies by the government, to create an equal footing for competition of scarce resources. Public enterprises may thus be forced to rationalize their operations along commercial lines.

The argument that privatization will improve managerial incentives will depend critically on whether or not privatization in fact increases the accountability of managers. Bureaucratic failures that give rise to principle-agent problems – whether the principals [governments] cannot provide effective incentives or adequate monitoring to guarantee that their agents [managers] pursue the principle, as opposed to their own, interest – may also arise in the private sector.

Privatization may improve allocative efficiency by exposing the firm to competition and weakening the monopolistic or quasi-monopolistic position of public agencies. Allocative efficiency can therefore emerge without a change in ownership structure. Privatization can in fact worsen allocative efficiency to the extent that the resultant private firm takes greater advantage of opportunities to restrict output and raise prices than the public enterprise.

Privatization cannot guarantee *a priori* an increase in economic efficiency. Two questions that arise are as follows: whether privatization makes it easier to increase exposure to market forces and whether a government pursuing such a policy option will be in a position to complement it with a judicious choice of other policies, most notably liberalization to promote competition and regulation to prevent anti-competitive practices⁴².

The general presumption in Western-type mixed economies is that liberalization can proceed faster and the resulting efficiency gains will be greater if liberation is accompanied by privatization⁴³. In Eastern Europe, there is broad agreement that privatization is a necessity. Previous attempts to combine decentralization coordination with state ownership – so called reform communism – suggest that without the incentive to private ownership, liberalization does not lead to effective competition. Consequently, the guidance of the command economy is removed, but efficient markets do not emerge to provide guiding signals in its place. Developing a market economy must therefore begin with the privatization of state enterprises. Privatization is necessary in order to consolidate the financial discipline imposed on enterprises during the stabilization phase. Of principle fear here is that labor unrest forces a relaxation of wage policy, which sets off a wage-price explosion. As regards structural issues, privatization is

⁴² Hemming Richard and Kenneth Miranda. "Privatization" in Chu Ke-young and Richard Hemming [1991] *Op cit* pp139-140

⁴³ Vickers, J. S., and G. K. Yarrow [1988]. *Privatization: An Economic Analysis*. Cambridge, Massachusetts: MIT Press in Hemming Richard in Vito Tanzi [1992] *Op cit* p81

probably the only way of quickly establishing private property rights and offers the prospect of effective corporation control of enterprise behavior, which are closely related features of a properly functioning market economy⁴⁴.

Public choice theory suggests that since the benefits of privatization will be spread out over a large number of people – but the costs will be borne by a small number, especially civil servants and public managers – the small group may voice strong opposition to the reform effort. This was however, contrary as witnessed in the case of Sierra Leone, where members of the civil administration were in fact the most interested prospective buyers of assets⁴⁵.

Privatization should not be for its own sake but should imply an environment where competitive firms are able to deliver goods and services efficiently, in terms of timeliness, value and cost. It is much more important to introduce competition, than it is to simply privatize the national carrier. Privatization should include market structure and policy environment. There must be public/private debate on policy options⁴⁶.

⁴⁴ Hemming Richard in Vito Tanzi [1992] *Op cit* pp81-82

⁴⁵ Hemming Richard and Kenneth Miranda. "Privatization" in Chu Ke-young and Richard Hemming [1991] *Op cit* p144

⁴⁶ Iain, T Christie "Comments on lessons of regulatory reform: Kenya's Experience" in Wallace, Laura [1999] *Op cit* p 40

1.7 HYPOTHESES

- Divestiture in Kenya is a political necessity as opposed to an economic necessity
- Political interference in divestiture has hindered the process of privatization.

1.8 METHODOLOGY

This study relied on primary and secondary data. The data collected was both quantitative and qualitative. Qualitative data included primary data, which consisted of interactive interviews given to individuals who have been directly or indirectly involved in the process of privatization from the following institutions: The Ministry of Finance – Department of Government Investment and Public Enterprise [DGIPE] and other Ministries concerned with divestiture; Institutions involved in policy analysis; Public Enterprises involved in divestiture; and a global financial advisory institution. Quantitative data relied mainly on secondary data, which included journals, IMF and World Bank publications and annual reports, publications from institutions such as the Institute of Economic Affairs as well as government policy papers.

CHAPTER TWO

THE LEGISLATIVE AND INSTITUTIONAL FRAMEWORK OF PUBLIC ENTERPRISES AND PRIVATIZATION IN KENYA

2.0 INTRODUCTION

The main objective of this chapter is to examine the political interests the government has in Public Enterprises [PEs] and the privatization process, expressed through their legislative and institutional framework. This chapter also examines the origins of PEs and public enterprise reforms and the legislative and institutional content of privatization, public enterprises and public enterprise reform policies.

Parastatals, state corporations, public enterprises, state owned enterprises, are terms used interchangeably to mean all those companies or organizations in which the government directly or indirectly owns a majority holding and some control in the board of management. For the purpose of this study, they will include enterprises with holdings of whatever magnitude. Therefore, whenever used in the study, they shall mean the same thing.

The legislative and institutional framework of PEs, Public Enterprise reform and of privatization is of extreme importance as they offer a suitable policy environment to private initiative. Political commitment to privatization and the

reform process is also expressed through this framework. Where the institutional framework and the rule of law have been strong, as in the case of Uganda, privatization has been a success; where they have been weak, as in the case of Russia, there has been serious political and economic chaos because an oligarchy has been allowed to arise out of the process of privatization. In Kenya, privatization has been jeopardized due to weak institutions, laws that are easily ignored, and laid down procedures that are undermined without serious penalties from established authority.

The chapter begins with the history of PEs, giving the general background to the legislative and institutional framework of PEs. The rationale for the establishment of PEs is highlighted as well as the problems they encountered. The background to the privatization policy and PE reforms summarizes the process the government undertook to rectify the problems faced in PEs through different reports and papers, which eventually led to privatization. Finally the legislative and institutional frameworks of privatization, public enterprises and public enterprise reform are given. Focus is placed on avenues where political influence could interfere with the public enterprise reforms and privatization.

2.1 The History of Public Enterprise in Kenya

The colonial government in Kenya established many public enterprises because they were to be the most efficient mechanism for providing certain services. These public services encompassed those that were not provided by the private sector or those that were of a monopolistic nature. It was considered undesirable to leave monopolies in private hands because of the exploitation that would have resulted. The Kenyan government created new enterprises following independence, both for the same reasons and to help promote Africanization and regional redistribution.

Shortly after independence in 1965, the new government expressed its philosophy about the role of the state in the economy in the famous Sessional Paper No. 10, *African Socialism and Its Application to Planning in Kenya*. The government committed itself to promoting rapid growth and equitable distribution. The government had no qualms about creating new forms with the purpose of accelerating Africanization of the economy.

The general principles governing the public enterprise laid down by the Kenyan government were these: they should be efficient at whatever line of business they engaged in, and efficiency was not to be sacrificed for other goals; they should be financially solvent; and they should foster growth and development of the private sector, especially among African entrepreneurs – but this private

sector activity was expected to be economically efficient and commercially viable. Since the major purpose of most of the public enterprises was to foster private sector activity rather than grow, high rates of return were not in general considered desirable.

Not everything went according to plan, however. Politicians were appointed to the boards of directors of many public enterprises, and allegations of nepotism and corruption were made periodically. There were demands for various types of cross-subsidy that were not always resisted as well as demands to Africanize public enterprise management, and in some cases promotion of African managers proceeded at a faster pace than their training. Import substitution was extended into areas where Kenya had no comparative advantage. All these resulted in declines in efficiency.

In 1979, a *Committee on Review of Statutory Boards* was appointed to review and make recommendations with regard to urgent financial, administrative, and operational problems facing important boards. The main recommendations were as follows: Parastatal managers were to be brought under tight control of central government; Terms and conditions of service were to be harmonized with those of the civil service and managers made transferable between parastatals and between parastatals and the civil service. In 1982, the *Working Party on Government Expenditure* found major problems among public enterprises. The

report of the 1982 working party took more cognizance of the fact that much of the responsibility for poor financial performance lay with the central government but it offered few recommendations that might help alleviate these problems.

The Working Party, highly critical of what it viewed as overextension of public enterprise into sectors that were strictly commercial, called for a program of divestiture. Had these recommendations of divestiture been followed, public enterprise would have been confined to enterprises with important social mandates, with the need for coherent government policy all the more pressing. However, there was no discussion of how this recommendation could be implemented or of how the problems originating in government policy could be resolved⁴⁷.

The report recommended that " *the Government should not direct a parastatal to carry out policy-related activities which might not be financially sound without providing explicit subsidies for those activities*⁴⁸ .

Sessional Paper No. 1 of 1986 on Economic Management for Renewed Growth shifted the paradigm from African Socialism to a market economy. The policies

⁴⁷ Grosh, Barbara. [1991]. *Op cit* pp11-18

⁴⁸ Kenya, Republic of. [1982]. Working Party on Government Expenditures. "Report and Recommendations of the Working Party," Phillip Ndegwa, chair. Nairobi: Government Printer, July 1982 in Grosh Barbara. [1991]. *Op cit* pp18

set out here were "aimed at restructuring the economy, mapping out patterns of government expenditure, and reorienting parastatal investments"⁴⁹." However, several years after its issue, government officials continued to refer to it as an "improvement" or "updating" of "Sessional Paper No. 1 of 1965". The State Corporations Act of 1986 followed the 1986 paper. This Act was the first clearly promulgated law that covered wholly owned state enterprises or those in which the government had a majority shareholding. Until then, state enterprises had been regulated by the specific Acts of Parliament that had brought them into being, as well as the various legal notice and policy circulars issued by the parent ministry. The Act also provided for a State Corporation Advisory Committee located at the Office of the President that would supervise the operations of these enterprises, while the Investments Division at the Treasury would oversee their investment and evaluate their performance⁵⁰.

2.2 The Rationale for Parastatals in Kenya

One of the main forces behind the establishment of state owned enterprises in Kenya was the desire to maintain a high degree of public control over national resources as a means of facilitating economic growth. This is clear from some of the objectives of and statements in the Sessional Paper No. 10 of 1965.

⁴⁹ Aseto, Oyugi and Okelo, J. A. [1997]. "*Privatization in Kenya*". Nairobi: Venture Books in Anyang' Nyong'o, P, G. K Ikiara, S. M. Mwale, R. W. Ngugi and Oyugi Aseto. [2000]. "*The Context of Privatization in Kenya*". Nairobi: Academy Science Publishers p69

⁵⁰ Anyang' Nyong'o, G. K. Ikiara, S. M. Mwale, R. W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* pp 69-70

According to Grosh⁵¹, Karanja⁵², and Oyugi⁵³, State Owned Enterprises in Kenya were expected to operate as instruments as well as factors for the implementation of the national development policy. Public enterprises were designed to serve as instruments of promoting social justice and co-operation with other countries or agencies, especially within the framework of production, international trade, technology transfer and financial flows through joint ventures with multinational firms.

Other reasons for expanding the public sector on Kenya included promotion of public entrepreneurship in areas where private capital was unavailable or where it was too risky for private investment; ensuring government influence in the national economy; creating competition to the private sector; creating employment opportunities for a productive workforce; improving income distribution patterns within various geographical regions; and spreading government influence through local authorities. State owned enterprises were expected to generate income revenue for the country's socio-economic development as well as pursue various socio-political objectives. These enterprises were expected to act as important instruments in the promotion of

⁵¹ Grosh, Barbara. [1991]. *Op cit* p168

⁵² Karanja, R. W. [1995]. "Privatization in Kenya" in Anyang' Nyong'o et al. [2000]. *Op cit* p45

⁵³ Aseto, Oyugi and Okelo, J. A. [1997] in Anyang' Nyong'o, G. K. Ikiara. S. M. Mwale, R. W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* p45

regional balance and equity through deliberate spatial distribution of industries and provision of public services, as well as Africanization of the economy⁵⁴.

2.3 Problems encountered in Public Enterprises [PEs] in Kenya

Public Enterprises may perform poorly for a number of reasons. Some of them include poor human resource deployment leading to poor management; unclear and/or contradictory goals; bureaucratic procedures; lack of sufficient working capital; excessive labor with high labor costs; lack of qualified technical personnel; poor state of machinery and equipment; non-commercial management approach; inability of respond to market signals; and frequent government intervention⁵⁵.

The performance of public enterprises started to deteriorate in the late 1970s when the sector began to rely too much on the treasury for its routine operations. The Kenyanization policy and the desire to industrialize made the government engage in massive public sector investments even in areas outside its traditional activities, that is, the provision of national defense and security utilities and transport. The presence of government and public sector firms in the economy remained high for most of the 1980s but the scenario began to

⁵⁴ Anyang' Nyong'o, G. K. Ikiara, S. M. Mwale, R. W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* pp44-45

change gradually from the mid 1980s as a result of increased budgetary pressure from the donors, through Structural Adjustment Programs [SAPs] and increased pressure on the exchequer.

Public Enterprises had largely failed to generate an investible surplus and instead created a major budgetary burden for the government. The government spent a lot on supporting individual cash-trapped parastatals. The civil service and the local authorities had become overextended, overstaffed and heavily mismanaged, adding pressure on the country's budgetary system. By the 1980s, and 1990s, excessive borrowing by public sector entities continued to have adverse effects on the overall national economic growth in terms of crowding-out effects. The public sector had the effect of entrenching monopolistic and oligopolistic structures in some sectors as a result of granting monopoly powers to parastatal firms, which exercised this power in sales and purchases, sometimes through state marketing institutions.

Grosh⁵⁶, Ndegwa⁵⁷, and Oyugi⁵⁸ state that the crisis in the public sector has often been associated with poor management, lack of professionalism in the

⁵⁵ United Nations – Department for Development Support and Management services. [1993]. *Methods and Practices of Privatization: Papers and proceedings of privatization workshops held in Kenya and Bangladesh – 1992*. New York p128

⁵⁶ Grosh, Barbara. [1991]. *Op cit* p25

⁵⁷ Kenya, Republic of. [1997]. "Review of Statutory Board's Report and Recommendations of the Committee Appointed by His excellency, the President." Nairobi: Government Printers in Anyang' Nyong'o, G. K. Ikiara. S. M. Mwale, R. W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* pp49

⁵⁸ Aseto, Oyugi and Okelo, J. A. [1997] in Anyang' Nyong'o , G. K. Ikiara. S. M. Mwale, R. W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* p49

management of PEs, with top appointments being determined by political factors and not always on grounds of merit and efficiency. The first primary limitation behind the crisis faced by PEs is the lack of clear-cut objectives to guide the operations of some of the enterprises. The price policy adopted by most of the enterprises was influenced by a desire to subsidize the consumers even in cases where the overall national economic policy did not explicitly require a subsidy. Thus frequently prices set below or above the market-clearing price led to surpluses or shortages resulting in an overall inefficient national resource allocation. Government intervention often forced some of the enterprises to procure inputs from specified sources when cheaper alternatives existed. Most enterprises could not consequently achieve their set goals.

Another contributing factor was the nature of relationships among the PEs themselves. In many cases, these enterprises were intricately interlinked with one another as well as private enterprises, through input-output relations. Consequently, inefficient operations in an enterprise affect operations of other enterprises and a chain reaction takes place with a number of industries suffering in the process. Kenya had its own unique problems that aggravated the crisis in the public sector. The collapse of the East African Community [EAC] in 1977 and the political and economic tensions that followed thereafter resulted in border closures that disrupted trade. Most affected were enterprises whose establishment had been specifically aimed at serving the regional market.

Financial policies applied in the enterprises accounted for the crisis as well. Financial decisions remained in the hands of the government, such as the levels of capitalization, fixed assets, working capital in the form required, and how much of the capital could be raised from equity and from long-term loans. For example, firms such as Nzoia Sugar, Sony Sugar Company and Kenya Airways were highly undercapitalized and therefore highly vulnerable to major policy changes⁵⁹.

2.4 Background to the Privatization Policy and Public Enterprise Reforms

The final policy decision to reform and privatize public enterprises is the result of several monitoring and evaluation exercises carried out by the Government over a 15-year period starting in 1978. Several task forces were constituted to deal with the poor performance of parastatals that had begun to impact negatively on the national budget.

The "**Review Of Statutory Boards Report**" of 1978 disclosed the enormous level of public investment in parastatals contrasted with the negative average rate of returns on investment, which they generated. The "**Report Of The**

⁵⁹ Anyang' Nyong'o, G. K. Ikiara, S. M. Mwale, R. W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* pp46-51

Working Party On Government Expenditure" of 1982 highlighted the problem of gross mismanagement of resources under the disposal of public enterprises and the total lack of accountability and transparency in their operations not to mention the arrears in their audited final accounts. The Report advocated for divestiture of run-down parastatals as the logical policy decision. The "**Divestiture Task Force**" followed, recommending immediate reforms and divestiture in the textile industry. However, the detailed findings were never published. The "**State Corporations Act**" stipulated radical measures to control and monitor the performance of parastatals. The Act achieved little but it brought into public focus the urgent need to end government involvement in commerce and industry. **Sessional Paper No. 1 of 1986 on "Economic Management For renewed Growth"** constituted a bold step by the government to restructure and reform the whole economy including the public sector. The private sector was now to be the "engine of growth". Together with the SAPs initiated in the mid-1980s the policies elaborated in the Sessional Paper No. 1 of 1986 were meant to stimulate economic growth through improved efficiency, creation of employment and development of entrepreneurship especially among the indigenous population. Finally the "**Policy Paper On Public Enterprise Reform And Privatization**" of 1992 laid the policy and institutional framework for privatization in Kenya⁶⁰.

⁶⁰ Kenya, Institute of. [1993]. Report on the Proceedings of "The Chief Executives Forum". *Impact of Economic Reforms and Privatization of Corporate Management in Kenya*. Nairobi: August 26th-27th pp32-33

2.5 The Legislative Framework of Public Enterprises and Privatization

2.5.1 The State Corporations Act

The State Corporations Act contains in it both the legislative and institutional guidelines for the running of parastatals, and was the operational document before the introduction of parastatal reforms. It still is, however, the legal document that governs the operations of SOEs. It is an Act of Parliament, which commenced on 1st November 1986. It makes provision for the establishment of state corporations; for control and regulation of state corporations; and for connected purposes.

Establishment and Power of State Corporations [Part II: Sections 3 – 4]

The President may, by order, establish a state corporation as a body corporate to perform the functions specified in the order. A state corporation established by order shall have perpetual succession; shall in its corporate name be capable of suing and being sued; and shall, subject to this Act, be capable of holding and alienating movable and immovable property. The President shall assign ministerial responsibility for any state corporation and matters relating thereto to

the Vice-President and the several Ministers as the President may by directions in writing determine.

Boards and Management of State Corporations [Part III: Sections 6(1) and 7 (1 and 3)]

Unless the written law by or under which a state corporation is established or the articles of association of a state corporation otherwise require, a Board shall consist of a chairman appointed by the President who shall be non-executive unless the President otherwise directs; a chief executive; the Permanent Secretary to the Treasury; and not more than seven other members not being employees of the state corporation, of whom not more than three shall be public officers, appointed by the Minister.

The President may give directions of a general or specific nature to a Board with regard to the better exercise and performance of the functions of the state corporation and the Board shall give effect to these directions. Notwithstanding the provisions of any other written law or the articles of association establishing and governing a Board, the President may, if at any time it appears to him that a Board has failed to carry out its functions in the national interest, revoke the appointment of any member of the Board and may himself nominate a new member for the remainder of the period of office of that member or he may constitute a new Board for such a period as he shall, in consultation with the State Corporations Advisory Committee, determine.

Inspector of State Corporations [Part IV: Section 18 (1), 20,21 and 22]

There shall be an Inspector of State Corporations whose office shall be an office in the public service and whose duties shall be to advise the Government on all matters affecting the effective running of state corporations; to report periodically to the Minister on management practices within any state corporation; and to report to the Controller and Auditor-General and the Auditor-General (Corporations) any cases where moneys appropriated by Parliament are not being applied by state corporations for the purposes for which they are appropriated. There is a Tribunal, known as the State Corporations Appeal Tribunal, which deals with appeals against decisions of the Inspector.

The State Corporations Advisory Committee [Part V: Sections 26 (1) and 27]

The State Corporations Advisory Committee consists of a chairman appointed by the President; the Permanent Secretary to the Treasury; the Director of Personnel Management; the Inspector of State Corporations; and eight other members appointed by the President. The Committee advises and performs any functions it is required to by the State Corporations Act. In addition, it has other duties to perform. With the assistance of experts where necessary, it reviews and investigates the affairs of state corporations and makes such recommendations to the President, as it may deem necessary. In consultation

with the Attorney General and the Treasury, the Committee advises the President on the establishment, reorganization or dissolution of state corporations.

Where necessary, it advises on the appointment, removal or transfer of officers and staff of state corporations, the secondment of public officers to state corporations and the terms and conditions of any appointment, removal, transfer or secondment. The Committee examines any management or consultancy agreement made or proposed to be made by a state corporation with any other party or person and advise thereon. Finally, the Committee examines proposals by state corporations to acquire interests in any business or to enter into joint ventures with other bodies or persons or to undertake new business or otherwise expand the scope of the activities and advise thereon⁶¹.

2.5.2 Privatization Policy

In 1991, the government entered into a policy framework agreement with the IMF and World Bank for the period 1991-92, which contained specific privatization activities and an indicative time frame amongst other economic reforms. In 1992, the government issued a *Policy Paper on Public Enterprise Reform and Privatization*, followed by two similar agreements between 1993-94, and 1994-97. The Policy Framework Papers [PFPs] became the basis by which progress in privatization could be measured. One of the PFPs of 1996 is entitled

⁶¹ Kenya. Laws of. [1987]. *The State Corporations Act. Chapter 446*. Nairobi: Government Printer. Revised Edition pp5-16

"Kenya: Economic Reforms for 1996-1998". Kenya's privatization policy is thus spelled out in a Policy Framework Paper on Privatization published in 1992 by the Ministry of Finance [MOF], updated in 1994 and published in June 1996.

The privatization process has continued without a specific privatization law passed by parliament. The issue could have been sorted out were the government to have successfully amended key laws in the financial sector proposed in 1994. In the book, "The context of Privatization in Kenya" by Anyang' Nyong'o and others, is an appended draft bill on privatization. The proposed Act intends to create a framework that brings about the transfer in ownership in assets organizations, commercial enterprises institutions or bodies corporate presently vested wholly or partially in the sovereign state of Kenya. The Act gives in detail the proposed process of divestiture and the bodies that would take part in it. The Act contains a section for the establishment of a consumer Complaints Tribunal with jurisdiction and powers conferred on it by the proposed Act with powers equivalent to the High Court. Also proposed is a Privatization Reform and Divestiture Commission, approved by the National Assembly⁶². Presently, a revised copy of the proposed bill is to be presented to parliament for debate and finally for the establishment of a privatization bill.

⁶² Anyang' Nyong'o , G. K. Ikiara. S. M. Mwale, R. W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* pp30, 60, 181-197

2.6 Institutional Framework of Public Enterprise Reform and Privatization

2.6.1 Public Enterprise Reform

The Department of Government Investments and Public Enterprises [DGIPE] within the Ministry of Finance is charged with public enterprise reforms processes. The DGIPE is also charged with the responsibility of initiating reforms in strategic parastatals not due for privatization in addition to overseeing the activities of non-strategic enterprises prior to their privatization.

The DGIPE is headed by a person of Permanent Secretary rank, reporting to the Permanent Secretary, Ministry of Finance, and has adequate authority to enable it to carry out effective oversight and leadership of the public enterprise reform process. Sector ministry functions in relation to PEs are limited to developing sector-wide policies and programs. PE boards of directors are responsible for setting corporate operational policies and to ensure that executive managements carry them out. The DGIPE represents the Government of Kenya's [GOK's] ownership function in regard to PEs and other investments in all sectors and exercises oversight and leadership functions in setting majority-owned PEs' strategic objectives and ensuring that those objectives are met. DGIPE's major tasks fall into two categories; the temporary task of designing and implementing the PE reform process; and the permanent tasks of centrally monitoring and supervising the performance of majority owned PEs and monitoring all

investments; carrying out effective PE debt management; and controlling, and ensuring PEs' accountability for all allocations to PEs as well as funds by PEs to GOK.

DGIPE's Role as Administrator/Manager Social Safety Net

The DGIPE administers/manages the substantive and institutional scheme for social safety net arrangements that addresses labor redundancies resulting not only from privatization /divestiture but also from rationalization of the remaining PE sector activities. The arrangements largely consist of various forms of cash benefits to protect workers' minimum consumption levels.

Role of Sector Ministries

Sector ministries develop sectoral policies and programs in their respective sectors. In the context of such policies and programs, they provide critical reviews of PE reform measures introduced and implemented by DGIPE and receive corporate plans and other key documents of PEs operating in the respective sector ministries' sectoral subject area. This enables sector ministries to contribute to the initiation and implementation of the Public Enterprise Reform Program [PERP] and its component parts. Sector ministries send to DGIPE any comments that they may have that have a bearing on such consistency and if necessary make any relevant suggestions towards enhancing such consistency.

Roles of PE Boards and Executive Management

PERP introduces major changes in corporate governance so as to achieve separation between ownership and management functions and enhanced management autonomy and accountability. PE boards' functions and composition reflect their character as the top organ of the PE that also provides the interface with its owners. Boards are actively and closely committed to and involved with supervision of management and its operations; individual board members are limited as to the number of boards they may serve on. Boards are expected to participate in the design of reform measures so as to make them effective in corporate practice; and cause executive managements to introduce relevant reform measures into day-to-day operations in a smooth and expeditious manner so as to produce the corresponding benefits as early as possible. It is up to the boards to have the right PE managers in place to produce improved performance⁶³.

2.6.2 Privatization

In order to achieve the government's aims for privatization, a high-level policy-making body was appointed by the President, the Parastatal Reform Programme Committee [PRPC], under the Chairmanship of the Vice-president and the

⁶³ Kenya, Republic of. [1994]. *Policy Paper on Public Enterprises Reform and Privatization*. Ministry of Finance: Department of Government Investments and Public enterprises together with the Executive Secretariat and Technical Unit. October. Pp6-9

Minister for Finance. The executing arm of the PRPC, the Executive Secretariat and Technical Unit [ESTU], acts as the secretariat of the PRPC and has been established as an autonomous executing agency and will be insulated from any Government or political interference.

The PRPC is charged with policy formulation, supervision, monitoring and evaluation of the program. In addition the PRPC prioritizes and determines the timing of the sale for each non-strategic PE; approves the operational guidelines for privatization to be followed by the ESTU, including the criteria and procedures to be followed in divestiture decisions; gives final approval or rejection for the sale of public assets. In the event of rejection, the reasons justifying the action be recorded; and provides political impetus for privatization and participates in building public awareness and the national consensus in support of the government program.

The ESTU is charged with the management, coordination and implementation of the divestiture program. Other functions include formulating and recommending policies, procedures, programs and operation guidelines for divestiture; preparing, with the collaboration of the holding companies where applicable, target lists of candidates for privatization for approval by the PRPC; and preparing, with the collaboration of the holding companies where applicable, PEs for privatization.

Other institutions include the Capital Market Authority [CMA], charged with the task of developing the capital market to increase its absorptive capacity and advising and authorizing public issue of shares for enterprises due for privatization, and the Nairobi Stock Exchange [NSE], which provides the institutional framework for share floatation, purchases and sales⁶⁴.

Privatization Implementation Team (PIT)

The privatization of each public enterprise is preceded by the formation of a PIT. This consists of a group of short-term consultants such as financial analysts, valuers, accountants, lawyers, engineers, technical officers nominated by holding companies, and industry specialists as required. The PITs are responsible for managing the detailed aspects of the divestiture operations⁶⁵.

2.7 LEGAL AND INSTITUTIONAL ISSUES AND PROBLEMS

The privatization process in Kenya was initiated without a proper legal framework though the Government and the World Bank argued the existing laws were adequate to provide the necessary framework. The *State Corporations Act [Cap. 446]* in which all public corporations were set up under, stipulates how corporations are established, their powers, their governance and what happens when dissolved. Section 28 of this act stipulates that where the State

Corporations Advisory Committee advises that a state corporation shall be dissolved, than nothing in this Act shall be construed as derogating from the procedure by which the corporation would be dissolve under the law by, or under which it was established.

Further, section 13 of the Act states that the assets of a corporation can be disposed of by way of sale or otherwise with the approval of the Minister and the treasury where such disposal has been taken into account in the estimates. In that regard, the Minister for the time being responsible for finance may, in consultation with the Committee, make rules for the acquisition and disposal of assets by state corporations and **different rules may be made with respect to different state corporations.** Such rules shall be brought to the notice of the state corporations **and other persons affected thereby,** but it shall not be necessary to publish the rules in the Kenya Gazette.

Section 30 of the Act gives the President the powers to assign responsibilities for any of the business of the government, including the administration of any of the departments of Government, to the Vice president and Ministries as the President may, by directions or writing, determine⁶⁶.

⁶⁴ Kenya, Republic of. [1994]. *Op cit* pp13. 36

⁶⁵ Anyang' Nyong'o, G.K. Ikiara, S.M. Mwale, R.W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* p73

The government did, however, realize that the law was not really adequate, and submitted certain amendments to Parliament on the *State Corporation Act, the Exchequer and Audit Act, and The Permanent secretary to the Treasury (Incorporation) Act* in June 1994⁶⁷. The gist of the amendments to the *State Corporations Act* was to establish the Department of Government Investment and Public Enterprises (DGIPE) charged with the responsibility of monitoring and supervising the performance of state corporations as well as all other Government investments. The department was also to carry out effective debt management of state corporations and ensure that state corporations are accountable for all budgetary allocations.

The Bill further established the office of the Investment Secretary as Head of the DGIPE, appointed by the President, and with the responsibility of formulating plans, and advising the government on the restructuring of state corporations and other public enterprises. The Bill also abolished the office of the Inspector of State Corporations, giving the functions to the Investment Secretary who was now directly answerable to the Minister of Finance as the Permanent Secretary in charge of parastatals and the privatization/reform program. With his advice, the Minister could from now exempt state corporations from any or all provisions of this Act. The Bill also abolished the position of executive chairman in state

⁶⁶ Anyang' Nyong'o, G.K. Ikiara, S.M. Mwale, R.W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* p 116

⁶⁷ Kenya, Government of. [1994]. *Kenya Gazette Supplement No 37 (Bills No. 6)*.

corporations, as they tend to interfere politically. The extent to which the boards of parastatals would make decisions of disposing of state assets without a central coordinating machinery was also limited.

The *Exchequer and Audit (Amendment) Bill, 1994* sought to provide for the powers of the Auditor-General (Corporations) to audit the accounts of corporations which are owned or controlled directly or indirectly by the Government specified by notice in the gazette by the Minister. The Bill also sought to enable the Investment Secretary to direct the Auditor-General (Corporations) to appoint a person nominated by him to audit the accounts of a state corporation without the Minister's approval. This would make it much easier, and faster to prepare public corporations for privatization.

The amendment to the Act, related to the incorporation functions of the Permanent Secretary to the Treasury, was to enable the Minister for Finance to give directions to the Permanent secretary to the Treasury, on the recommendations of the Investment Secretary, regarding voting rights on behalf of the government in relation to shares held in any company by the Government. Further, it gave express powers to the public corporations to dispose of their assets under terms deemed fit by the corporation.

These proposals were, however, withdrawn as the amendments to the *Exchequer and Audit Act* were being debated. The government gave reasons for the withdrawal of the bills and instead privatization went ahead with the assumption that the Policy Paper on reform provided as adequate guideline for implementation. Unfortunately, there have been consequences for not having passed the amendments.

The PRPC and the ESTU have centrally coordinated the program, in reality. Planning of the process has been weak and the choice of which enterprises are divested seems to have been ad hoc. PRPC and ESTU, having not been given sound legal basis, have had to bargain from a position of weakness vis a vis other government departments and agencies. The ESTU, in situations where receiver managers have been appointed to liquidate parastatals, have had little power to influence the course of events.

The PRPC and ESTU have no legal authority to prepare and execute privatization transactions because they cannot sue and be sued in a court of law, nor is there any legal remedy if the privatization agency fails to adhere to transparent processes. Indeed, even the World Bank⁶⁸ recommended specific additional legislation to empower the privatization agency. The government has avoided

⁶⁸ World Bank. [1998]. *Privatization in Kenya. 1991-96, mimeo, August, Nairobi* in Anyang' Nyong'o, G.K. Ikiara, S.M. Mwale, R.W. Ngugi, and Oyugi Aseto [2000]. *Op cit* p 119

tabling a privatization law in Parliament for the fear that this would delay the process. Since prior approval of Parliament is required in the case of privatizing those corporations subject to the *State Corporations Act*, the World Bank sees no problem with the absence of a privatization law. In any case, the Act gives the President the power to exempt a state corporation from the provisions of the Act, and this would always be used to speed up privatization.

This exemption power has tended to be abused by the executive branch. For example, although Kenya Airways was subsequently privatized successfully, the original process involved acrimony between Parliament and the executive precisely as a result of the lack of clarity in law⁶⁹.

⁶⁹ Anyang' Nyong'o, G.K. Ikiara, S.M. Mwale, R.W. Ngugi, and Oyugi Aseto. [2000]. *Op cit* p 116-119

CHAPTER III

PARASTATAL REFORM AND PRIVATIZATION: THE KENYAN EXPERIENCE

3.0 INTRODUCTION

The main objective of this chapter is to examine the implementation of privatization and public enterprise reform policies. The chapter analyses the problems and issues internal to the processes such as how have the institutions set up to take privatization and parastatal reform operated? What are the problems they encountered and how have they dealt with them? Also examined is the importance of politics in privatization, which could be looked at as the ethnic and partisan interests in divestiture. An important question asked is whether the politics in parastatals make necessary the divestiture process.

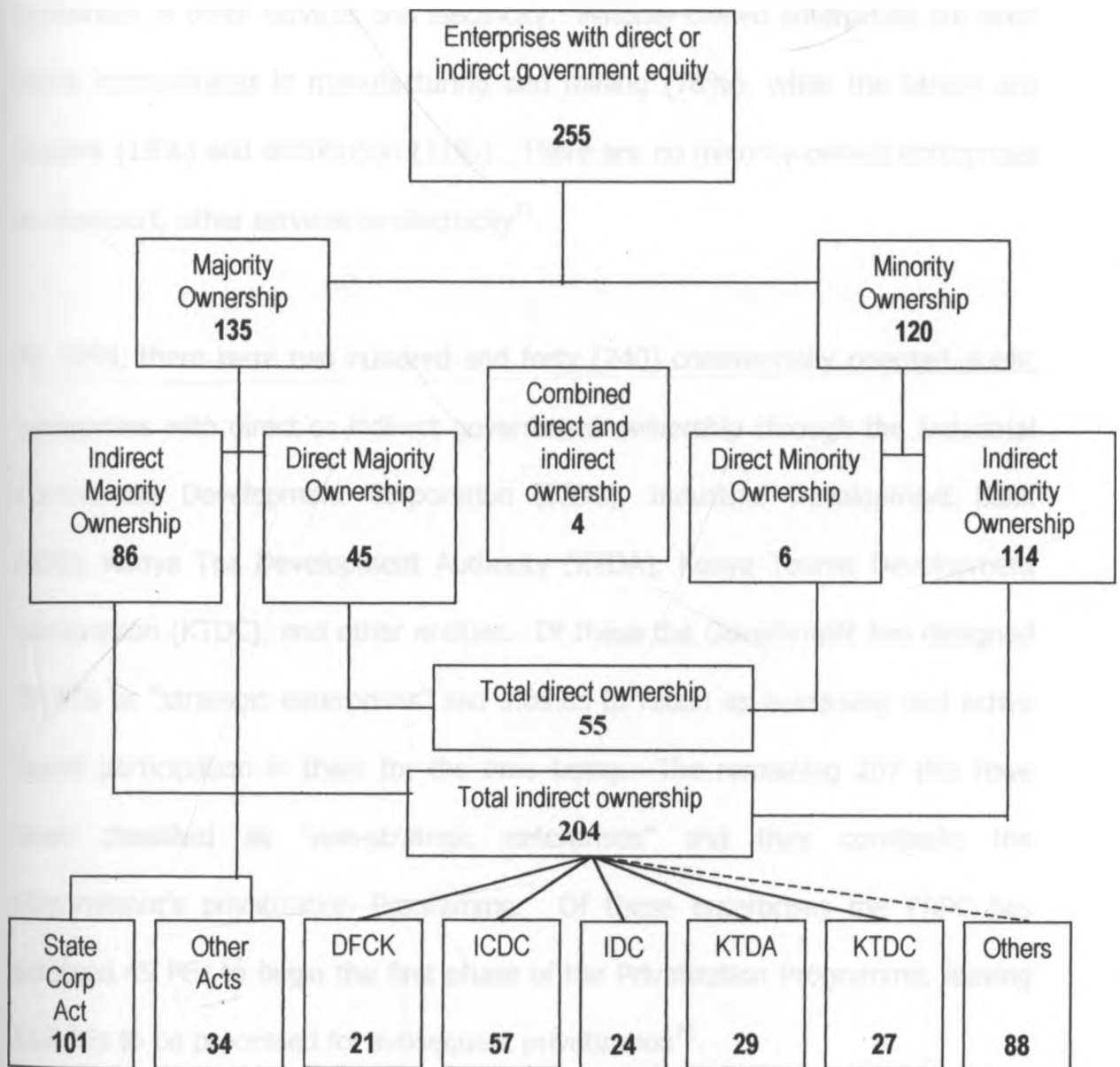
Among the issues examined are the objectives and principles of privatization and public enterprise reform set and whether the institutions set up for the processes followed the required procedures. Various methods of privatization are highlighted and the Kenyan experience in privatization examined. Also analyzed are the problems that have been faced in the process of privatization with examples of privatized state corporations given.

3.1 STRUCTURE, COMPOSITION, AND CATEGORIES OF PARASTATALS

At the onset of parastatal reform and privatization in Kenya, there were 255 public enterprises in which the government participated directly and indirectly through equity. In terms of the ownership structure, the government had majority ownership in 135 companies and a minority ownership in 120 public companies. Total direct ownership was 55, out of which 45 were majority owned and only 6 minority owned by the government while 4 had combined direct and indirect ownership. The government had indirect ownership in 204 firms, out of which 86 were majority owned and 114 minority owned. Of the majority owned, 101 were formed under the Corporation Act, while the remaining 34 were formed under various Statutory Acts. Sixty percent of the enterprises were in the manufacturing and mining, 18% in distribution, 15% in finance and the rest in transport, other services and electricity⁷⁰. Figure 3.1 summarizes the above information.

⁷⁰ World Bank. [1998]. *African Development Indicators, 1998/99*. Washington D.C.: [Table 10-1, p. 265; Table 10-3, p. 267; Tables 10-10 to 10-12; Table 11-1, p. 275].

Figure 3.1: The Structure of the Parastatal Enterprise Sector in Kenya



Among majority-owned enterprises, manufacturing predominates (40%), followed by distribution (26%), finance (18%), transport (8%), with the remainder in other services and electricity. Minority-owned enterprises are even more concentrated in manufacturing and mining (76%), while the others are finance (13%) and distribution (11%). There are no minority-owned enterprises in transport, other services or electricity⁷¹.

By 1994, there were two hundred and forty (240) commercially oriented public enterprises with direct or indirect government ownership through the Industrial Commercial Development Corporation (ICDC), Industrial Development Bank (IDB), Kenya Tea Development Authority (KTDA), Kenya Tourist Development Corporation (KTDC), and other entities. Of these the Government has designed 33 PEs as "strategic enterprises" and intends to retain its ownership and active Board participation in them for the time being. The remaining 207 PEs have been classified as "non-strategic enterprises" and they constitute the Government's privatization Programme. Of these enterprises the PRPC has selected 45 PEs to begin the first phase of the Privatization Programme, leaving 162 PEs to be processed for subsequent privatization⁷².

⁷¹ World Bank. [1992]. *Kenya – re-investing in stabilization and growth through public sector adjustment*. Washington D.C.: World Bank pp 68-69

Categories of parastatals

The government has established the following categorization of enterprises:

	Strategic	Non-Strategic
Viable	Retain	Sell
Non-viable	Restructure/Retain	Liquidate

Strategic in the matrix above refers to enterprises, parts of enterprises or the commercial functions of administrative/regulatory bodies, that are deemed vital to national security and those providing essential goods and services, especially infrastructure services and utilities. All other parastatals are classified as **non-strategic**. **Viable** parastatals cover all enterprises that are commercially profitable under the current and proposed economic policy environment. All others are deemed **non-viable**. The category of potentially viable enterprises is omitted intentionally, because gradual sale of viable enterprises will be able to tackle potentially viable ones⁷³.

⁷² Kenya, Republic of. [1994]. *Policy Paper on Public Enterprises Reform and Privatization*. Ministry of Finance: Department of Government Investments and Public Enterprises in conjunction with the Executive Secretariat and Technical Unit. October. Pp1-2

⁷³ United Nations: Department for Development Support and Management Services. [1993]. *Methods and Practices of Privatization: Papers and proceedings of privatization workshops held in Kenya and Bangladesh – 1992*. New York. Pp 130-131

3.2 THE OBJECTIVES AND PRINCIPLES OF PARASTATAL REFORM

3.2.1 OBJECTIVES

The main objective of parastatal reform is to improve productive efficiency throughout the economy, in both the public and private sectors. Other objectives include: reducing the financial and administrative burdens that parastatals impose on the Government; raising revenues from the sale of state-owned assets; dispersing capital markets; attracting foreign investments, management skills and technology; eliminating preferential treatment to allow a level playing field for parastatals and the private sector; and improving the enabling environment for the private sector⁷⁴.

The objectives of the Public Enterprise Reform Programme (PERP) are: to enhance the efficiency and performance of the PE sector; to reduce the financial burden of the sector on Government; and to achieve these objectives through the introduction of reforms that will enforce financial discipline, mobilize managerial and financial autonomy and set up adequate accountability and appropriate incentives, all toward the aim of having PEs operate in commercial principles⁷⁵. For the PERP to attain its objectives, a broad range of actions will be undertaken. Non-strategic parastatals will have to undergo a process of divestiture or liquidation. This may include management contracts with private

⁷⁴ World Bank. [1992]. *Op cit* p92

⁷⁵ Kenya, Republic of. [1994]. *Op cit* p5

enterprises with an initial risk sharing; part divestiture retaining substantial government ownership or reducing it to a minority; dilution of government ownership through floating new equity; full divestiture; or part minority divestiture of government ownership accompanied by a partial privatization of management including board representation.

Changes also have to be made in the enabling environment for the remaining parastatals. Changes could range from restructuring the organizational structure; contracting out commercial activities to the private sector; having management contracts with minority private sector ownership; permitting private sector competition for existing state monopolies; and removing potential conflicting objectives. Improvements in the regulatory process also have to be made. It would include separating the regulatory role, market intervention and commercial functions; transferring commercial functions to a corporate entity from a statutory board; divesting commercial functions; performing the regulatory function through *ex post* enforcement rather than *ex ante* administrative controls; and eliminating legislative, policy or financial support and preferential treatment of parastatals undertaking commercial activities to enable the private sector to compete on a more equal footing⁷⁶.

⁷⁶ United Nations: Department for Development Support and Management Services. [1993]. *Op cit* pp 131-133

3.2.2 PRINCIPLES OF PE REFORM

The actions of the PERP are based on the following principles: the operations of PEs will include only viable commercial activities unless directed by the Government Of Kenya (GOK) to undertake non-commercial activities; PEs will operate on a self-sustaining basis and subsidies will be faced out except for non-commercial activities which will be given by the GOK; PEs will move to market pricing whenever competition is possible; PEs operating under monopolistic conditions will be regulated through autonomous, specialized bodies operating independently from the government line structure, insulating them from political interference; the Companies Act will be made applicable to PEs; political interference in PE management will be cut off through a transparent manner of operations carried out by the management, giving them freedom to achieve their objectives and appointing them through a transparent process; and PE business will be performed in a commercial and transparent manner with no exemptions from taxes or fiscal charges⁷⁷.

The 1993/94-budget speech outlined several policy actions to be undertaken by strategic parastatals. A program was to be put in place for reforming and monitoring investment, debt service, and revenue generation in strategic parastatals such as Kenya Posts and Telecommunications, Kenya Railways, Kenya Power and Lighting, and the National Cereals and Produce Board. The

⁷⁷ Kenya, Republic of. [1994]. *Op cit* pp5-6

debt reconciliation exercise was to be completed by the newly established DGIPE for loans and grants made by the Treasury in these parastatals. Finally, a study identifying direct and indirect subsidies and other financial assistance leading to an action plan to gradually mitigate the subsidies by the commercializing the strategic parastatals operations was to be completed⁷⁸.

Lacking an overall policy framework for the parastatal sector, efforts to improve efficiency have tended to follow a case-by-case approach, many times in response to a deteriorating situation in an individual enterprise or the emergence of a crisis which focuses the public's attention or begins to impact noticeably on the Government's budget. In such circumstances, the Government has generally responded by changing management and issuing a set of instructions to deal with the immediate problem. As a result, progress in parastatal reform has been slow and ad hoc. Moreover, because the Government's corrective measures have not dealt adequately with the underlying causes of parastatal inefficiency, reforms are inherently short term in nature and constantly in danger of being reversed. Privatization emerges as a visible element of a parastatal reform program but it should not be viewed as an end in itself. Privatization should be seen as a broader effort to promote productive efficiency, strengthen competitive forces of the economy, and support entrepreneurial development⁷⁹.

⁷⁸ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p76

⁷⁹ World Bank. [1992]. *Op cit* p91

3.3 THE CONTEXT OF PRIVATIZATION AND THE POLITICS OF PRIVATIZATION

Hemming and Mansoor⁸⁰ narrowly define privatization as the transfer of public sector assets and activities to the private sector. In a broad sense, it involves not only the sale or other form of transfer of state assets, but also the transfer of the management of state enterprises to the private sector accompanied by a radical reallocation of the available productive resources⁸¹. The Second Nigerian Economic Summit held in May 1995 in Abuja defined privatization as policies aimed at transferring full or partial ownership and control of public enterprises to the private sector to encourage competition and emphasize the role of market forces in place of statutory restrictions and monopoly power⁸². This study will adopt the combination of these three definitions, which put together the process, and the ultimate goal with the process.

Privatization takes place at the microeconomic level, where public enterprise rehabilitation, restructuring, or commercialization policies retain government ownership but seek to make public enterprises more efficient through improved management incentives, streamlined enterprise-government relations, and market-based pricing criteria. In this case, neither public ownership nor public

⁸⁰ Hemming, R., and A. M. Mansoor. [1998]. "Is Privatization the Answer?" *Finance and Development*, 25, September in Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p2

⁸¹ Shirley, M.M. [1993]. *Managing State-Owned Enterprises*. Washington, D.C.: IBRD in Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p2

management is reduced. Ravi Ramamurti⁸³ observes that privatization works best when combined with policies at the macro-economic level that liberalize the strategic environment in which the private enterprises operate, such as general price deregulation, opening the economy to foreign competition, removal of monopolies and so on.

In defining politics, authors such as Hague and Harrop⁸⁴ take a rather neutral approach by defining politics as the process by which groups make collective decisions. The size of the group can vary from a single family to one extreme to the international community at the other. Ridley⁸⁵ goes further by defining politics as the study of human beings in situations where political decisions have to be made, in respect to the allocations of resources, choices involving the exercise of power. Aristotle's view of politics is outlined by Wiseman⁸⁶ as the activity by which differing interests within a given unit of rule are conciliated by giving them a share in power in proportion to their importance to the welfare and survival of the whole community. Politics is a way of getting things done governmentally, the process of making power operative. It is governance in action.

⁸² Etukado, A. [1997]. Issues in Privatization and Restructuring in Sub-Saharan Africa. *WP IPPRED-5* in Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p83

⁸³ Ramamurti, R. [1999]. "Why Haven't Developing Countries Privatized Deeper and Faster?" *World Development*, 27:1 in Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p3

⁸⁴ Hague, Rod and Martin Harrop. [1987]. *Comparative Government and Politics: An Introduction*. London: Macmillan Education Ltd. p3

⁸⁵ Ridley, F. F. [Ed] [1975]. *Studies in Politics*. London: Oxford University Press. p16

⁸⁶ Wiseman, Victor H. [1969]. *Politics: The Master Science*. New York: Pegasus pp11-12

This study captures the decision-making aspect of politics as fundamental in the definition of the politics of privatization. The politics of privatization is a result of the activity and process by which collective decisions are made regarding the full or partial transfer of the ownership and control of public enterprises to the private sector.

The decisions could be influenced by factors both internal and external to the process of privatization and they involve the exercise of power. For the purpose of this study, the politics of privatization is *the decision-making process or activity, which involves the exercise of power, that interferes with the process of privatization.*

3.4 OBJECTIVES OF PRIVATIZATION

The Government of Kenya has listed certain national objectives to be achieved under the privatization programme. The objectives aim at: freeing government resources from economic and social development support services; encouraging private sector growth, thereby reducing the burden of economic development on the Treasury; increasing economic efficiency through effective utilization of resources guided by market forces and competition; stimulating the development of the capital market; broadening the base of enterprises ownership; providing urban and rural employment; reducing the external debt-burden; attracting foreign investment; building public confidence and support in the reform and

privatization process and creating the necessary enabling environment and institutional framework for ensuring transparency and accountability in the whole process of transferring goods into private hands⁸⁷.

3.5 PRINCIPLES OF PRIVATIZATION

The principles guiding privatization are as follows: enterprises will be divested into competitive markets; purchasers will not obtain an intact or unregulated monopoly. Purchasers will not be accorded special protection or access to credit on concessionary terms. In cases where the Government retains a minority shareholding, it will not exercise any special or extraordinary voting rights, except in a limited, predetermined and well-defined policy area. Excluding financial and operational (but not physical) restructuring that are necessary to prepare state enterprises for sale, there will be a moratorium on new government investments in enterprises that are to be privatized.

All privatized sales will be on a cash-only basis, with the possible exception of shares sold to the workforce of the affected firms. No specific class of potential purchasers will be excluded from participating in the process. All transactions will be conducted in an open transparent manner, consistent with normal standards of commercial discretion.

⁸⁷ Kenya Institute of Management. [1993]. *Op cit* p33

To promote and ensure the competitiveness of the markets in which privatized companies will operate, the Government will continue to build upon existing anti-monopoly legislation and the institutional capacity to implement it in a transparent manner, including publicizing it. The sale of a PE or portion thereof to another PE or public institution will not be considered as privatization. No new parastatals will be established in the productive sector, except for investments made purely for venture capital assistance through the restructured Development Financial Institutions [DFIs]⁸⁸.

3.6 METHODS OF PRIVATIZATION

Several methods are used in transferring assets/ownership from the public to private sector. These include sale or transfer of shares, sale of assets, leasing arrangements, management contracts and liquidations. While objectives set for privatization dictate the method used, the realization of goals set, whatever the method used, is dependent on several factors. These factors influence the action to take and the speed of the process. They include the legal status of the enterprise, performance of the enterprise, size of the enterprise, objectives set for the enterprise, the privatization process and the overall economic development process, government share of ownership, and the enterprise economic activity.

⁸⁸ Kenya Institute of Management, [1993]. *Op cit* p33

There are three general forms of privatization: ownership, management, and decontrol. These give rise to two major classifications. In the first group, ownership of assets remain with the government but there is transfer of control from the public to the private sector, where the private sector or management takes a contract with the government to provide public services at a fee. The methods used include service contracts, management contracts, lease arrangements and concessions. These methods have been applied extensively in the strategic enterprises. The second category involves partial or full ownership transfers to the private sector, through BOOT (build-own-operate-transfer) (concession), BOT (build-operate-transfer), BOO (build-own-operate) (de-monopolize), Reverse BOOT, joint ownership and outright sale (liquidation, direct sale, public floatation, and management/employee buyout).

Service contracts entail retention of operation and maintenance of the system, commercial risk and financing of fixed assets and working capital from the government. The private sector is contracted for maintenance, emergency, billing and collection duties, while it manages its own personnel and services. In management contracts, management is privatized but not ownership, so that the private sector has the freedom to make day-to-day management decisions without assuming commercial risks. The leasing arrangement method allows the private firm to rent facilities from the government and assume the responsibility for operation, maintenance and management of the system. The private firm

The Divestiture method promises government revenue to pay down debts or other government obligations while in some cases it distributes share ownership across the population. Sale of public enterprises or divestiture is carried out through public floatation, private placement, direct sale, and management buyouts. Public floatation is through formal capital market of full or part of the government shares as a going concern. Direct sale or direct transfer to chosen private agents is a highly vulnerable option due to political opposition from the existing workers and political lobbies. It is appropriate for large shares when the objective is to achieve widespread ownership and to gain public approval, with transparency.

Public enterprises are sold through competitive bidding if an enterprise is no longer viable as a going concern, while the performance record is appalling including the accumulation of large debts. Thus, it faces high search costs and creates monopolies because it does not allow widespread ownership. Competitive bidding demonstrates transparency, although this may be done at the expense of technical improvement. Management buyout is the sale of assets to the employees who, with appropriate loan provisions from banks, take over ownership so that managers and employees have a controlling shareholding. It is mainly taken when it is in the interest of the government to encourage employee ownership. Liquidation is the ultimate step in the arsenal of the owner either as sale of assets to someone that uses it for provision or as a response to

also takes up the commercial risk but has no obligation to invest in the enterprise. It is the responsibility of the government to meet capital expenditure, debt servicing, tariffs, and cost recovery policies. Concessions involve temporary transfer of a state-owned facility to a private operator or the construction of a new facility by a private firm on condition that it is transferred to the government at the end of the concession period. The private firm operates the state-owned enterprise at its own commercial risk and accepts the investment obligations. Fixed assets, however, remain the property of the government.

De-monopolization allows for private firms to enter the market at their own risk as the government de-monopolizes a market segment in whole or in part. Thus the private firm complements or competes with the government. BOOT contract is where a private sector participant finances, builds, owns, and operates a new facility and then transfers ownership later to the public authority. This kind of contract attracts new plants that require large amounts of financing. The public sector determines the size of the facility as demand is guaranteed by the contracting agency. Two alternatives for BOOT include BOT, where the private firm only builds and operates while the ownership is transferred to the public sector; and BOO where there is no transfer to the public enterprise.

the failure of the enterprise, which may have stopped operation or is in bad shape. It could also be that there is no buyer of the enterprise and rehabilitation is not feasible and the government is not willing to continue subsidizing production⁸⁹.

3.7 THE PROCESS OF PRIVATIZATION

The policy paper on privatization and parasatatal reform has prepared guidelines for a divestiture process involving two processes: *preparation* and *execution*. The preparation phase largely involves the PIT but also draws from the DGIPE and the DFIs. This phase was set up for divestiture by conducting an analysis of the public enterprise in question, so as to determine a realistic range of values for the targeted enterprise and develop a credible sales strategy. This phase would result in a number of written reports⁹⁰ that would serve both as a guideline for future action and as documentation verifying to the ESTU and PRPC that the analysis is thorough and complete. The key document presented to the ESTU by the PIT is the Privatization Action Plan, which constitutes the original blueprint to be followed during the execution phase.

⁸⁹ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* pp83-96
⁹⁰ The reports include a *Technical Issues Memorandum, Financial Issues Memorandum, Asset Valuation Report, Legal Issues Memorandum, Operational and Financial Projections and Sensitivity Analysis, Valuation Memorandum and Marketing Memorandum. These can be consolidated into the Privatization Action Plan.*

The execution phase entails the implementation of the transactions. All key decision makers including ESTU, PRPC, Treasury and others, would have approved the Privatization Action Plan prepared during the preparation phase. The following tasks should have been completed: the sales documentation, any financial and operation restructuring required prior to divestiture, resolution of all outstanding legal issues affecting the sale, and the design and implementations of public relations campaign to inform the public of the impending sale⁹¹. Several key reports would be produced during this stage such as the information memorandum, bidding documents, government permits, agreements related to the transfer of ownership, and public relations documents. Detailed documents were also to be provided for the sale, which was to be executed by the tender evaluation committee whose members included the Executive Director, ESTU (chair), the Treasury, the parent Ministry of the enterprise, the holding company of the enterprise, and any other professionals ESTU may have deemed necessary to co-opt.

ESTU was allowed to use any of the known methods of privatization such as public offering of shares on the Nairobi Stock Exchange, sales of shares by private placement, negotiated sales in case of pre-emptive rights exercised, sale of enterprise assets (including liquidation), new private investments in

⁹¹ *The stages are publication of tender notice, pre-qualification of bidders, tender evaluation committee, public opening of tenders, evaluation of tender bids, and award of sale.*

enterprises, employee/management buy-out, and leasing or award of management contract⁹².

3.8 DIVESTITURE AND THE ROLE OF POLITICS IN DIVESTITURE

Divestiture captures PE reforms of whatever magnitude at one end and privatization on the other extreme end. Several privatization methods have been used especially those that involve sale of government shares or assets. None of the methods that retain ownership of assets with the government have been used. The choice of method reflects the category of enterprises targeted in the first phase, that is, the non-strategic enterprises. Also reflected is a heavy influence of the type of enterprise (in terms of legal status, performance), and the adopted policy of minimal financial restructuring before sale. These methods include liquidation, targeted for perpetual loss-making enterprises, competitive bidding mainly for those that could not qualify for the stock market as a demonstration of transparency of the process, public floatation for enterprises with good performance, pre-emptive rights, partial divestiture which was accomplished through public floatation and pre-emptive rights, and management buyouts. Receiverships were common especially for enterprises with liquidity problems, and acted as a transitory process waiting for the final action to be taken.

⁹² Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* pp75-76

Liquidation enhances the role of the private sector if there is market for the commodities being produced and the technological advancements to warrant the purchase of equipment. Among the enterprises liquidated, majorities had already closed their doors and were facing stiff competition from the private sector. Out of the 14 enterprises liquidated, only two yielded positive proceeds, which constituted 0.014% of the total proceeds realized by September 1998. Poor performance of enterprises hindered the wider use of the public floatation, and the non-restructuring strategy adopted hindered the uplifting of enterprises for floatation. Only in Kenya Airways was restructuring carried out to maximize returns from sale, and also because of the nature of service provided. Despite the limited use of public floatation, the method yielded the highest percentage (60%) of the realized proceeds.

Pre-emptive rights was a popular method of privatization, given the legal status of the enterprises. The company laws under which these enterprises are registered stipulate that the existing shareholders must give their consent to any of the partners to sell shares to an outsider. Only in one enterprise did the shareholders fail to exercise this right. Otherwise the shareholders have the first option to buy the shares before they are offered to anybody else. This generated only 20% of the proceeds realized although it involved over 50% of the privatized enterprises. The low proceeds are because the government was a minority shareholder and therefore only a small proportion of shares were being

traded. Also, the shareholders offered low share prices to take advantage of their legal power making it impossible to search for a buyer with a better price.

Partial divestiture was achieved mainly through public floatation and pre-emptive rights where the government retained less than 47% of the total shares. The contribution to the total proceeds of the partially divested enterprises was 36% (30% of those divested through public floatation and 6% through pre-emptive rights), with two enterprises privatized through share dilution. Competitive bidding has a high potential of promoting the activities of the private sector. Despite taking 13% of the enterprises, through this method, the government was only able to realize a share of 0.092% of the total proceeds.

Table 3.1: Total Number of Enterprises Privatized 1991-1998

Year	Liqui- dation	Recei- vership	Pre-emp rights	Public floatat.	Comp bidding	Mgt- buyout	Partial divestiture	Total
1992	6	1	2	-	-	-	3	12
1993	1	5	9	2	2	-	-	19
1994	1	2	7	1	3	-	-	14
1995	3	5	12	-	4	-	-	24
1996	1	1	6	4	2	1	-	15
1997	2	2	16	2	5	-	1	28
1998	-	3	-	-	-	-	8*	11

**These were the subsidiaries and associate companies of Kenya Commercial Bank.*

Source: Anyang' Nyong'o, P., G. K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto.

[2000]⁹³.

⁹³ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p101

Table 3.2: Sector Distribution of Privatized Enterprises

Sector	Number	Percentage of the total
Agriculture	15	1.3
Forestry	2	1.7
Mining	3	2.6
Manufacturing	5	39.1
Trade	1	0.9
Hotel and Tourism	19	16.5
Transport	5	4.3
Real estate	2	1.7
Other services	13	11.3
Financial	6	5.2
Engineering	4	3.5
Total	115*	100

**Ten of the subsidiaries and associated companies were merged with the parent company*

Source: Anyang' Nyong'o, P., G.K.Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto.

[2000]⁹⁴

⁹⁴ Anyang' Nyong'o, P., G.K.Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p104

The distribution of privatized enterprises indicated that 39% were in the manufacturing sector, of which 14 enterprises (31%) were in the textile industry. The services sector shared 43.4% of the total enterprise with a high proportion (38%) in the hotel and tourism sector and only 5.2% in the financial sector. Although the government has set objectives for the different sectors of the economy, the same is not implied by the approach adopted of case by case instead of sectoral approach. It reflects the ad hoc method that was used before 1992, and leaves a lot to be desired especially in meeting the sectoral objectives at general development level. It also reflects weaknesses in terms of government commitment and strength in paving the development path.

Kenya adopted a case-by-case approach, starting with the loss making, indebted, or the already closed enterprises. There was also a heavy concentration on small enterprises, many of which had existing private shareholders with preemptive rights. Consequently, minimal proceedings were realized. While efforts of capture comparative advantage across the broad categories of enterprises were made, little was made across non-strategic enterprises. The adopted case-by-case method leaves a lot to be desired on how to achieve the objectives of specific sectors, for example, in the textile and tourism sectors. Again, although the methods selected attempted to cover all the objectives set for the program

this can only be done to a minimum level, especially in the efforts to develop the capital markets, and raise government revenue⁹⁵.

Privatization has both an economic and an ideological aspect. The ideological aspect is in terms of how it is adopted into the system of a country. In Africa, for example, it is incorporated in the context of African socialism. The adaptation process is based on what works. The privatization process is an economic one, the politics arising out of the role played by politicians in the process. Viewing privatization entirely from a political angle may blur the benefits accrued from the process. Privatization touches an area where politicians are largely involved and interferes in an area where politicians have power. It therefore touches on both economic and political issues; the economic issues involved having political implications. Economics and politics cannot therefore be separated from privatization⁹⁶.

Another respondent is of the view that privatization is both an economic and political process because it involves getting the private sector into what was once a public sector utility, and politics thus plays a key role. There are economic, social and political implications in privatization. The government may own assets for many reasons, which may not necessarily be economic thus selling the assets, may involve selling the interests in the PE, which are not necessarily

⁹⁵ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* pp98-108

⁹⁶ Respondent one; Oral interview, 3/7/2003

economic⁹⁷. Both political and economic issues intertwine in the process of privatization. The role of politics is seen in the authority needed to disperse parastatals. Privatization as an economic process requires a supportive political environment⁹⁸.

Privatization is an economic process that requires political will. Politics plays a role in privatization in the disposing off of public assets to the private sector, politicians being involved in making these decisions⁹⁹. Politicians have a role they play in privatization because not only do they make decisions regarding privatization, but they are also the custodians of PEs on behalf of the public and are therefore primary determinants in the success of privatization¹⁰⁰.

Privatization is a political process to the extent that what is being privatized is actually owned by the public. Politics comes in because many people may want to have a say as to how their resources are used. Many utilities have been politicized as well, for example, employment is based on who one knows, and the government has other times instructed state corporations to increase employment. In the event of concessions, the effects of the political system are brought to bear¹⁰¹.

⁹⁷ Respondent two; Oral interview, 21/7/2003

⁹⁸ Respondent three; Oral interview, 8/7/2003

⁹⁹ Respondent four; Oral interview, 3/7/2003

¹⁰⁰ Respondent five; Oral interview, 30/6/2003

¹⁰¹ Respondent six; Oral interview, 9/7/2003

The impact of politics on privatization depends on the kind of politics brought into privatization. Politics that is focused on improving the lives of people would have a positive effect on privatization. If politicians are against the process, then it may take some time to get the people to own the process. Politicians have a lot to do with the success of privatization because they make policies. If they are for privatization, it may succeed and probably earn more because investors may be drawn to a politically conducive environment¹⁰².

Politics plays a role in privatization in the area of decisions made regarding privatization. Given that these decisions are made throughout the process of privatization, privatization as an economic process has political implications.

3.9 WEAKNESSES, POLITICAL INTERFERENCE AND THE NECESSITY OF DIVESTITURE

The necessary policy guidelines and institutions have been set up for the privatization process but the existence of these did not make the process more open and accountable. Anyang' Nyong'o attributes the problems to the failed economic trusteeship project where the state claims to own economic resources on the basis of economic trusteeship on behalf of its citizens (nationalization) and a similar claim to dispose of these economic resources on behalf of the same citizens (privatization).

¹⁰² Respondent one

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¹⁰² Respondent one

Ethnic and partisan considerations deviated the original public economic trusteeship from development of a proper state sector investing for the public good. The ethnic and partisan interests have undermined the capacity of the state to implement an open and accountable disposal of the investments made on behalf of the public.

Forces that have deviated from the original hand have interfered and are indeed handling the privatization process. One of the forces is that of "straddlers". "Straddling" is a term used by Cowen and Kinyanjui in 1971 and expanded by Swainson¹⁰³. This occurs when individuals are involved in both permanent employment and private accumulation. The Ndegwa Commission of 1968¹⁰⁴ recommendations led to subtle and then increasingly overt use of the economic trusteeship for personal and partisan use since the mid 1970s. The combination of economic trusteeship and straddling led to the construction of a patriot-client state. The state had the power to reward its partisans with economic largesse generated either by the parastatals or by allowing them access to economic opportunities it controlled¹⁰⁵.

¹⁰³ Nicolo Swainson. [1980]. *The Development of Corporate Capitalism in Kenya 1918-1977*. HEB in Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p77

¹⁰⁴ *The Ndegwa Commission recommended permitting public servants to engage in business.*

¹⁰⁵ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p77-78

position to raise the capital necessary for buying some of the lucrative enterprises being privatized. A good number of foreign firms have used pre-emptive rights to ensure continued ownership of shares in divested firms.

With regard to the DGIPE in the Ministry of Finance, it has been observed that there is lack of consensus in decisions made regarding privatization within government departments involved in the process. The law is inconsistent regarding privatization in that the parties involved operate under different Acts of Parliament. For example each PE is under an Act which dictates how it should be sold, yet there exists a Treasury Incorporated Act, allowed to sell parastatal shares. The process of synchronizing both Acts in Parliament is time taking and difficult. In many sectors, the structures present do not allow for privatization. Legal impediments also arise, for example, in the selling of shares in the case of pre-emptive rights. Loss making companies cannot also be floated in the Nairobi Stock Exchange [NSE]¹⁰⁷. Besides the DGIPE has no institutional framework and operates under no legal backing. The privatization process therefore lacks autonomy¹⁰⁸.

The laws of pre-emptive rights have been used, in various cases to undersell government investments. For example, the Kenya Tourist Development Corporation sold its shares, by pre-emptive rights, in 1991 to Ms Sololo

¹⁰⁷ Respondent one
¹⁰⁸ Respondent four

Kenya's privatization program isolated 33 strategic parastatals, which control close to 70% investment in the public sector. Privatizing these would have substantial impact on the economy yet ~~they~~ are the most difficult to privatize since the bureaucratic bourgeoisie is likely to have more vested interests here. Procurements, contracts, over-invoicing and various rent seeking activities have been observed by the Auditor-General (Corporations) to characterize the lack of transparency in these parastatals. Complicated ownership structures, particularly in the power and telecommunications sector, make for a difficult process of restructuring before privatization can be undertaken. In what Kenya regards as "strategic parastatals", privatization is likely to be partial, retaining majority shareholding as a control board¹⁰⁶.

The ESTU has experienced resistance to the privatization process from sector ministries, DFIs and enterprise managers. Quite often, these institutions, making the work of the ESTU difficult, do not observe the laid down procedures for privatization. Since there is no law giving ESTU specific powers to override any resistance, the process has at times been subjected to unnecessary bureaucratic delays and bottlenecks. The government has also been accused, in certain cases, of variously favoring some interest groups in the process of privatization. Further, there has been concern that foreign interests may be favored at the expense of domestic interests, especially when they tend to be in a better

¹⁰⁶ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p14

Investments Limited, for a value way below the market value and what other bidders offered. The public Investments Committee of Parliament subsequently recommended, in two consecutive reports, the nullification of this sale and that the Attorney General take appropriate measures to institute criminal proceedings against the persons involved in any fraudulent activities during the sale of the shares of the state owned enterprise¹⁰⁹. Here was an indication that the state did not earn needed revenue from this transaction.

The case of the Milling Corporation of Kenya, sold through competitive bidding, was even more contentious. This involved an outright sale of a wholly state owned enterprise through competitive bidding. Although the bidding was apparently carried out, the Auditor General Corporations observed major irregularities. A special audit was carried out which revealed that the enterprise was not sold to the highest bidder, nor did the purchaser – Premier Flour Mills (PFM) – pay the 10% down payment on time. Even after a series of hearings and recommendations made by the Public Investment Committee, PFM continued to be in possession of the enterprise¹¹⁰.

¹⁰⁹ Public Investment Committee, Kenya National Assembly. [1994]. *Report of the Public Investments Committee*. Nairobi: Government Printers. Pp208-211

¹¹⁰ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p32

The privatization process requires the cooperation of the enterprises, holding companies and Government ministries. The World Bank notes that in practice, DFIs and the ESTU have avoided this thorough approach and there has been very little done in the preparation of enterprises for privatization, as dictated by the evidence given. For example, Kenya Airways and Housing Finance Corporation of Kenya (HFCK) undertook their preparatory work for privatization, entailing a serious risk of conflict of interest. For instance, the readying of Kenya Airways for privatization raised a lot of controversy in Kenya¹¹¹.

In 1992, Kenya Airways had been accumulating losses since its establishment in 1977 and had a negative net worth of shillings 11 billion. It had defaulted on debt to external lenders amounting to shillings 4.5 billion and 1.6 billion to the government. A government proposal in a Sessional Paper to the National Assembly to absorb the 4.5 billion shillings received stiff resistance from parliamentarians. The latter felt strongly that Kenya Airways should continue to operate profitably and pay its own debt before trying to privatize.

The government, however, went ahead to convert the government debt (1.6 billion) into equity and to take over the external debt to shillings 4.5 billion. The restructuring process also involved the appointment of a new board of directors with the mandate to commercialize the airline, the strengthening of the

¹¹¹ Kamau, Lewis. [1998]. *The Kenya Airways Experience*. paper presented at the seminar of Privatization: Are We on Course? Institute of Economic Affairs, 12th November

management team, reduction in the aircraft and an increase in the utilization of the remaining aircraft. Profitability and efficiency was emphasized, with staff being given proper training to be conscious of customer needs and prompt efficient delivery of services.

By 1993/94, the airline was already showing signs of being turned around. Kamau points out that in the period March 1994 to March 1998, the company's total cumulative net profits amounted to Kenya shillings 7.8 billion, a sum way above the 4.5 billion the government had to pay as a "sunk in cost" to turn the airline around. This having been achieved, privatization followed in the 1994-96 period. Through a strategic investment by KLM purchasing 26 percent of the shares, the airline proceeded to offload 51 percent of its shares on the Nairobi Stock Exchange to individual Kenyans (22%), institutional investors (12%), foreign investors (14%), and employees of the company (3%) while the government continued to retain 23 %.

It has also been noted that the ESTU and PRPC have, in certain cases, been drawn in lengthy battles with prospective purchasers even after sales have been apparently completed. Some of the problems arise as a result of the legal complexities while others arise as a result of the laid out procedures not being followed. The World Bank has taken issue with the ESTU over its lackluster

compliance with its own regulations¹¹². The World Bank (1998) observes that holding companies, including DFIs, have influenced the pace of privatization. Some have even resisted the move. In certain cases, holding companies have not taken the boards of directors seriously, and have even missed crucial meetings when discussions affecting the future of the firms are being taken. Sometimes agreements reached regarding privatization have been left to lapse, presenting awkward situations in which the government has lost money due to the under-selling of its shares. This was the case with the Industrial Commercial Development Corporation (ICDC) in the sale of government shares in Firestone (E.A) Ltd., in 1994, to Sameer Investments Ltd¹¹³.

As observed by a respondent from a global financial advisory institution¹¹⁴ Kenya does not have a sophisticated market, which includes key decision makers, investors and the public. The market does not understand that privatization is not getting rid of an asset but changing who controls the asset. The players in the market do not understand the process. The legal framework is also inadequate to facilitate the process effectively, for example, there is no privatization law, the judiciary is not yet independent, the financial market is not solid enough for borrowing, and so on. These factors hinder investment.

¹¹² World Bank. [1998]. *Privatization in Kenya, 1991-96*, mimeo, August, Nairobi in Anyang' Nyong'o, P., G.K.Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p126-128

¹¹³ Anyang' Nyong'o, P., G.K.Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto [2000]. *Op cit* p128-131

¹¹⁴ Respondent two

In the process of privatizing Kenya Railways, many people will lose their jobs by the time the concessionaire comes in. Most employees are not sure whether the safety nets provided by the Government will be sufficient and available. Many of them are thus against the process. The present guidelines and procedures need enforcement, in the absence of a law. There is no legislation to empower the process. By the time Kenya Railways is being sold, it is hoped that a law will be in place to give force to a more transparent system and that the people managing the process would have legitimate power separate from the shareholder, which is the Government¹¹⁵.

Since privatization is in a major way in the hands of the Government, local economic policy analysis institutions cannot easily access information for assessment, especially information on offers in the buying of parastatals. It has also been observed that the process is slowed down because it is majorly in the hands of the Government¹¹⁶.

In the case of Kenya Re, there was a lack of policy in its privatization. The Government was reluctant to privatize despite the fact that it was categorized as non-strategic. The Corporation was often rushed and put through the rigorous and expensive process of due-diligence¹¹⁷ when pressure was put on the

¹¹⁵ Respondent six

¹¹⁶ Respondent five

¹¹⁷ *This is Generally the process of taking stock of the assets of a company.*

Government by the World Bank to privatize. The process of trying to privatize Kenya Re was therefore very expensive¹¹⁸.

Weaknesses in the process can thus be deduced. The absence of a clear backing of the privatization process by a law has made the process weak in terms of transparency and accountability. The lack of a clear ownership of the process has contributed to a lack of consensus in decisions made regarding the process of privatization, slowing it down. These weaknesses have opened a window for political interference in the process.

Privatization in Kenya has been accused of being donor driven. There has been a lack of consensus in favor of privatization. The government's reluctance to fully support privatization is seen not only in the casual way in which the relevant agencies were set up, but also in the sequencing of parastatals to be privatized. The delay in restructuring and privatizing the major enterprises, so called strategic ones, has not endeared the government to the Breton Woods institutions. In spite of the volume – in terms of sheer numbers – of privatization already accomplished, the donor community does not seem to be impressed by the quality and the likely positive impact of the process so far¹¹⁹.

¹¹⁸ Respondent three

¹¹⁹ Aseto, Oyugi and Jasper Okelo. [1997] *Privatization in Kenya*. Nairobi: Basic Books, pp44-45 in Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p140

Indeed, political interests have been seen in parastatals whereby politicians would like to control PEs and may thus be opposed to privatization¹²⁰. The process has been done in an ad hoc manner suggesting that the Government has not been committed to privatization. Each privatization case has been treated exclusively with no clear law governing the process. As a result, high profile jobs in PEs have been used as rewarding tokens¹²¹. Politicians would like to reward those who are politically inclined to them. The system for appointment in PEs is also closed, that is, it has no open mechanism for appointment. As a result, those who have been appointed on political grounds oppose the process. Others have contracts with PEs and oppose privatization, as this would deprive them of their contracts¹²².

Kenya's past experience in privatization has shown that political interests have played a part in determining what would happen in the privatization process. For example, political interests determined the outcome of trying to privatize the Kenya Post and Telecommunications Corporation [Telkom Kenya]. The environment for selling was right, the interests expressed sufficient. The sale was, however, stopped because politicians decided that the selling price was too low¹²³. In the case of Kenya Re, there were political interests in the corporation. The Corporation was not open to tender and it was later discovered that the

¹²⁰ Respondent four

¹²¹ Respondent five

¹²² Respondent one

¹²³ Respondent four

corporation was going to be sold to a few politically correct individuals, at the time. It was the interference of politicians that stopped the sale of the corporation¹²⁴.

In a lot of cases, however, there are no political interests in the process of privatization. What is experienced, contrary to what most would believe is the efforts put in by the Government to make correct decisions that may result in slowing down the process. For example, the Government may have been committed in the privatization of Telkom Kenya but those who were willing to buy the corporation did not offer the price expectations of the Government. The Government may possibly have opted out of privatization because its objectives were not attained. The fact that the objectives may or may not have been economic doesn't necessarily mean that the Government was not committed to privatize the corporation.

Political commitment has been exercised sometimes, and sometimes it hasn't. Some PEs have been privatized for example Kenya Airways, and others have not for example, Telkom Kenya and Kenya Re. Reluctance by the Government to privatize was observed in the case of Kenya Commercial Bank [KCB]. Issues such as an inadequate legal framework for privatization and lack of ownership of

¹²⁴ Respondent three

the privatization process are intertwined in the process of decision-making. Political interests cannot, therefore, be easily extrapolated in privatization¹²⁵.

A law that would address the issues that make privatization unsuccessful would go a long way in bringing comfort to the process. The law would give a legal framework to the process of privatization, discounting issues such as a lack of transparency and accountability and reducing the chances of abuse of the process of privatization, thus standardizing the process. With a legal framework, parliamentarians may not get an excuse to interfere in the privatization process¹²⁶.

A privatization law would entrench the process of privatization in the law, making it a legal process, reducing interference that is not within the law¹²⁷. A privatization law would give an institutional framework for the running of PEs and privatization. Political interference would thus easily be reduced, because interfering would mean facing the law¹²⁸. A privatization law would entrench the process of privatization in the law but not the substance of privatization. The substance of privatization, for example in the case of Kenya Railways, is

¹²⁵ Respondent two

¹²⁶ Respondent two

¹²⁷ Respondent one

¹²⁸ Respondent four

addressed through the concession agreement and through the amendment of the Kenya Railways Act¹²⁹.

Indeed, political interests in PEs have interfered in the process of privatization. Of contention is how to distinguish between good and bad interference in the process. The reluctance shown by the Government to privatize some PEs suggests a lack of commitment, despite the recorded success stories of privatization. It is evident, though, that a privatization law would entrench the process in the law and possibly reduce political interference in the process.

Barbara Grosh¹³⁰ shifts parastatal problems squarely on the State Corporations Act, which she states was designed to shift blame for parastatal problems onto the shoulders of managers and directors of parastatals. One-fourth of its sections details the machinery by which directors will be prosecuted for any deviation from the plan approved by the parent ministry. It cannot be denied that corrupt or inefficient managers are found in Kenyan parastatals. This, however, is neither the origin of problems found in parastatals nor the primary cause of the problems observed. Most of the problems originate in decisions taken by civil servants who regulate public enterprises. Policies that centralize more and more decisions out of the enterprises and into the ministries will exacerbate these

¹²⁹ Respondent six

¹³⁰ Grosh, Barbara. [1991]. *Op cit* p25

problems. They will also demoralize these public enterprise managers who are doing their best to operate firms under difficult circumstances.

The 1995-96-budget speech listed the accomplishments of the government in privatization. Among the accomplishments listed were the transfer by KTDA of its shareholding in 43 tea factories to smallholders, reduced shareholding in Kenya Airways, Kenya Commercial Bank, and National Bank of Kenya; the institution of performance contracts at National Cereal and Produce Board (NCPB), Kenya Ports Authority, and Kenya Railways; and the removal of monopolistic/privileged market positions of Kenya Planters Cooperative Union (KPCU) (coffee milling), KNTC (sugar trading), NCPB (grain buying), Kenya Co-operative Creameries (KCC)(milk distribution), NOCK (crude oil imports) , and Kenya Petroleum Refineries (refined products)¹³¹.

In trying to determine the political or economic necessity of privatization, it is important to establish whether privatization as a process is necessary. It has been observed that Kenyanization¹³² has remained merely presentational through Government ownership; parastatal's operations have become inefficient and unprofitable, partly due to multiplicity of objectives; existence of parastatals in commercial activities have stifled private sector initiatives, and many of the joint

¹³¹ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p76

¹³² *Increasing Kenyan citizen's participation in the economy; promoting indigenous entrepreneurship; redressing regional imbalances and promoting foreign investments through joint ventures.*

ventures have failed, requiring the Government to shelter major financial burdens.

The Government lacks resources to put into infrastructure and the public sector can no longer sustain many state corporations. State corporations provide low cost services therefore their resources are not being recovered to cater for the services provided. Borrowing public sector money is expensive because the money has been factored, for example, to cater for political risks. Besides, funds that come from outside come with the condition to privatize.

Privatization therefore emerges as a workable alternative. Privatization ensures efficiency in organizations and reduces bureaucracy. Simply operating state corporations, as commercial entities may not work because the government has responsibilities in parastatals and tends to convert these responsibilities to bureaucratic processes, reducing efficiency. Lack of funds inhibits the competitiveness of state corporations with other entities, requiring state corporations to privatize¹³³.

The Government has no business in some commercial activities it is involved in, for example, banking, power distribution, and so on. The business of the Government is to govern, and leave those who are best placed in conducting

¹³³ Respondent one

business activities to do so. The Government should provide guidance, correct frameworks and an enabling environment for business. Privatization is therefore necessary. The rationale for investing in national resources and assets is no longer there. The global trend is that governments are concentrating on the role of providing legal, social, and political frameworks for doing business and not getting into business, owning or funding assets.

The Government is also not best placed in doing business for example in terms of technical know-how and in exerting the right influences and decisions. The Government should play a facilitative role and target those best placed and supplement the services provided without providing the service itself. From an economical perspective, the private sector is more efficient given the right incentives. Looking at the issue from the economic benefits accruing from privatization, leaving business to the private sector may bring more profit¹³⁴.

The rationale behind the privatization of Kenya Re was that the Government resources were supposed to be directed to social programs and not business. There were other companies in the private sector that could more efficiently run the reinsurance business. Besides, the Government was not being fair by being a player in the game as well as being the regulatory body¹³⁵.

¹³⁴ Respondent two

¹³⁵ Respondent three

Kenya Railways has experienced long and cumbersome procurement procedures, making the management inefficient. For Kenya Railways to make a substantial contribution to Kenya, then it has to be in private hands. It is hoped that in private hands, procedures and processes will be streamlined, the management will own the system, and the employees will be highly qualified and properly paid and may be sacked if they prove to be inefficient. If the concession design is done well, then the performance of a privately run railway is likely to support many other sectors of the economy and create more jobs in these sectors. It has been observed that this transport system need not be a massive employer but should be a facilitator in getting things done. The fewer the people in this transport system, the cheaper the goods being transported, the end term benefits being registered in the economy. This business will therefore be better placed in the hands of others other than the Government¹³⁶.

Privatization is an economic necessity¹³⁷, necessary where public enterprise services are not rendered well to the public. With competition, it is likely that the quality of service will be better. Though the World Bank introduced privatization to Kenya, it has adequate support to be termed as necessary. Lack of ownership of the process and a policy environment that does not directly favor the process give the impression that privatization is not necessary which is contrary to what Kenya needs. Privatization in Kenya is a necessary economic process.

¹³⁶ Respondent six

¹³⁷ Respondent five

There have been cases of very successful privatization since the exercise started. The most successful ones have been through public floatation of shares, for example Bamburi Portland Cement Co. Ltd. (1991), Uchumi Supermarkets Ltd. (1992) and East African Oxygen Ltd. (1993). The sales by competitive bidding and through pre-emptive rights have had mixed results. In certain cases, like the sale of cotton ginneries, the prices at which the factories have been sold to the buyers have always been contentious¹³⁸. It has not always been clear whether political and social objectives are the prime factors in motivating the transactions as opposed to economic reasons. In either case, it is equally important to record the rationale for the actions taken by the ESTU as political and social objectives may at times be justified as economic reasons.

¹³⁸ Anyang' Nyong'o, P., G.K. Ikiara, S.M. Mwale, R.W. Ngugi and Oyugi Aseto. [2000]. *Op cit* p33

CHAPTER FOUR

SUMMARY, CONCLUSION AND RECOMMENDATIONS

4.1 SUMMARY

The divestiture process in Kenya has faced a number of setbacks. One objective of this study was to examine the legislative and institutional framework of privatization. Privatization has been carried out amidst an unclear institutional and legislative framework. The Privatization Program Committee and its Secretariat, the Executive Secretariat and Privatization Unit were not set under a Presidential Decree. As a result they have relied heavily on administrative support from other ministries, which, in many cases, was not forthcoming. In the absence of procedures and guidelines entrenched in the law, there has been interference in the process, resulting in its delay, through lack of cooperation in the preparation for privatization. It was also observed that the number of times transactions would be referred to the Cabinet ended up being a source of delays.

The absence of a privatization law has also contributed to the weakness of the program. Legal advice obtained from the Attorney General indicated that the country had adopted adequate commercial laws to facilitate the Privatization Program. As a matter of policy, Development Finance Institutions [DFIs] could dispose off mature projects to generate funds to invest in new development

projects, while the Treasury, through the Treasury Incorporated Act could buy and sell shares under the Companies Act. The key weakness was that the Policy Paper on Public Enterprise Reform and Privatization, which provided policy guidelines including the procedures and the institutional framework, was not entrenched within any law. In many cases procedures were overlooked and after some time the Privatization Reform and Privatization Committee [PRPC], which was a subcommittee of parliament became dormant. In addition, auditing of the privatization process was also not entrenched within the law.

The privatization program has not adequately broadened the base of ownership of shares, as intended. In some cases, shareholders had pre-emptive rights, which they were not willing to waive. In other cases, companies did not have the profitability record necessary to float shares through the NSE while in some cases the cost benefit analysis of spreading shareholding was not positive. It was observed that in the case of competitive bidding, many Kenyans with adequate resources to buy companies did not express interest. As a result, privatization in Kenya has not had a significant impact on the economy.

Most of the enterprises privatized were relatively small and self-sufficient hence not depending on Government budgetary resources. In addition, their contribution to the budget, with respect to privatization proceeds, was minimal. Further, most of them owned by the holding companies, which have remained a

drain to the Treasury, were not affected. Financial and management resources attracted through the program were thus minimal. These weaknesses established in the second and third chapters of the study have opened a window for politics to interfere in the privatization process. An important role of the government in the privatization process emerges as that of decision-making. Politics plays a role in privatization in the disposing off of public assets to the private sector, politicians being involved in making these decisions.

4.2 CONCLUSION

The study establishes that privatization and PE reforms are necessary for Kenya, not because of political pressure but because it is an economic necessity. Divestiture is an economic necessity because the Government lacks resources to service state corporations. In addition, there are other entities, which are better placed in engaging in commercial activities as opposed to the Government. Simply operating state corporations as commercial entities may not work because the Government had responsibilities in parastatals and tends to convert these responsibilities into bureaucratic processes reducing efficiency.

From a financial perspective, there is need to adopt international practices whereby in many countries infrastructure is operated by the private sector. Based on this trend most of Kenya's development partners have tied finances which were earlier accessible to the public sector as loans and grants to

privatization of infrastructure facilities. This study therefore discounts the hypothesis that divestiture in Kenya is a political necessity as opposed to an economic necessity.

Political interference in the process of privatization has both positive and negative aspects. The impact of politics on privatization depends on the kind of politics brought into privatization. Indeed, ethnic and partisan interests have weakened the process of privatization. In many cases, however, the process has been slowed down or stopped because of the efforts put in by the Government in trying to make proper decisions regarding privatization. Political interference in the process of privatization is intertwined with many issues such as an inadequate legal framework for privatization and a lack of ownership of the process. The reasons for political interference in the privatization process cannot, therefore, be conclusively extrapolated from the decisions made and branded as hindrances to the process.

There have been some cases of successful privatization, some contentious cases, and some cases where privatization has been postponed. This study therefore concurs with the hypothesis that political interference in divestiture has hindered the process of privatization with reference to ethnic and partisan interferences.

4.3 RECOMMENDATIONS

Privatization in Kenya has been carried out without a proper legal framework, which has resulted in the weakness of the program. Indeed, there is need for the Government to establish a privatization law. The privatization process should be entrenched within a law to reduce interference in the process that is not within the law. The law should also ensure transparency and accountability in the process, and deal with the issues that make privatization in Kenya wanting. The law should in addition give the institutions involved in the process, the PRPC and the ESTU, legal authority to prepare and execute privatization transactions. It should also provide a legal remedy if any privatization agency fails to adhere to transparent processes. The law should aim at reducing incidents of corruption within the process of privatization and at the same time establish a clear framework for the restructuring of strategic state corporations. A clear reorganization of the legal and institutional framework regarding the monitoring and supervision of parastatals and the privatization process will go a long way in improving the process of privatization and reducing the politics in the privatization process.

Privatization in Kenya has been accused of being donor driven. There has been a lack of consensus in favor of privatization especially among parliamentarians. Lack of ownership of the process has resulted in setbacks in the privatization process. Shareholders with pre-emptive rights were not willing to waive them and many Kenyans with adequate resources to buy companies did not express

interest. The Government should educate Kenyans on the opportunities available to them to contribute to national development through participating in the privatization process. At the same time, the Government should act as a creator of a favorable setting within which Kenyans can develop themselves and the economy by encouraging active participation by more Kenyans in shareholding. In doing this, the Government should ensure that it is not only the rich who are getting richer but that the common man is also enriched in the process. The Government should create ways of enabling the common man to invest in shares for example through loans.

More effort should be put in encouraging and facilitating the private sector to participate in the privatization process as they have a lot to contribute to national development. As the study reveals, the private sector is better placed and better equipped in carrying out commercial activities as opposed to the Government. Ownership of the process of privatization may go a long way in creating a culture of patriotism, which may in turn reduce the politics experienced in the privatization process.

The existence of administrative hurdles has provided needless opportunities for corruption and interference in the process of privatization. Top management in parastatals has many times been appointed because of their political affiliation. As observed in chapter two, holding companies and DFIs have jointly contributed

to the slow pace of privatization. It is within these administrative hurdles that the politics in privatization is clearly portrayed. Those appointed on political grounds and those who benefit from doing business with state corporations oppose privatization. The Government should ensure that appointments made in parastatals should be out of merit, the mechanism made open and fair. Tenders and contracts in state corporations should be awarded in a transparent manner. Dismantling these hurdles would contribute in reducing the politics in privatization.

Kenyans should embrace privatization and look at it as an opportunity for engaging in business and contributing to national development. Privatization should be undertaken for the benefit of all Kenyans to avoid a few individuals benefiting from the process. The divestiture process should be made more transparent and information should be made available to ensure accountability. This would make it easier for those in the academic field to assess the process and give more informed and reliable contributions towards the divestiture process. Analysis of the divestiture process could take a positive dimension and concentrate on improving the process to benefit the whole society.

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