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**Privatization of Public Enterprises in  
Zambia: An Evaluation of the Policies,  
Procedures and Experiences**

by

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African Development Bank

The views and interpretations in this paper are those of the author  
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#### Introduction

The term Privatization is often loosely used to mean a number of related activities, including any expansion of the scope of private sector activity in an economy and the adoption by the public sector of efficiency enhancing techniques commonly employed by the private sector. While acknowledging that no definition of privatization is water tight, we will define privatization, for the purpose of this paper, as the transfer of productive asset ownership and control from the public to the private sector.<sup>1</sup> The transfer of assets can be total, partial or functionary, with the sale being implemented by methods such as private sales, leasing arrangements, employee buy outs and share issues. In Africa, many governments have embraced the idea of privatization, brought to the fore mainly as a part of the adjustment and stabilization programs of the mid-eighties and the nineties. Privatization now frequently features in government policy statements and in conditionalities from donors. The past decade has also seen the World Bank and other donors get increasingly involved in lending operations towards parastatal sector reforms that included privatization components.

African countries share a number of common features in relation to the drive towards privatization. For most of these countries, the first twenty years of independence were characterized by rapid growth, driven by favorable terms of trade and high levels of public investments in infrastructure and services. The development of import substituting industries brought in the dramatic rise of parastatal corporations, which were also used as vehicles for increased local participation in the economies. Many governments moved to nationalize existing foreign interests in their countries and also to create new state enterprises to carry out the various production and trading functions. Parastatal corporations rapidly dominated the extractive industries, manufacturing and financial sectors of their economies, and acquired important economic and political status, becoming major sources of employment. The moderate growth experienced in the seventies, however, was quickly reversed by the financial crisis of the early eighties, and associated inefficiencies made parastatal sector reform a major element in the reform efforts implemented by the countries.

Zambia was one of the earlier countries to embark on a major privatization exercise as part of its economic reform program started in 1992. Although progress was initially slow, mainly due to the inertia associated with start up activities and generally opposition from interested parties<sup>2</sup>, the program picked up momentum in the last two years, culminating in the rapid divestiture of public enterprises that many have compared only to privatization programs in eastern Europe. This paper reviews the privatization program in Zambia, highlighting the major tools and mechanisms employed, and the achievements and constraints faced by the authorities in privatizing one of the largest public sectors in Africa. The paper begins with a brief overview of the main economic issues surrounding moves towards privatization of public enterprises.

#### Privatization Objectives and Rationale

Privatization and private sector development is justified on a number of micro and macroeconomic considerations. These are examined in the following sections.

#### Microeconomic Issues

A body of theory has now fully emerged, which seeks to explain the superiority of private over public ownership, with the economic arguments resting on a number of hypothesis about the relationship between ownership, management incentives and market structure on the one hand and performance on the other. Privatization, it is argued, enhances both productive and allocative efficiency. The main arguments are that under public ownership, enterprises are often used to pursue non-commercial objectives of government,

including employment maximization and uneconomic investment choices. These activities are very often inconsistent with efficient and financially viable performance and lead to poor managerial supervision. Private ownership on the other hand is associated with better defined profit maximization objectives which lead to higher levels of performance and the institution of effective forms of incentives. This is the major argument for privatization in terms of efficiency: the switch from public to private ownership resulting in the adoption of more precise and measurable objectives on the part of the owners which create the environment and incentives to monitor and control management more effectively (Adams, 1993). Additionally, under private ownership, firms will only remain in existence as long as they are viable. Should they cease to be viable, their resources will be reallocated by the market to other uses. This is contrasted to the poorly performing parastatal organization whose life is extended by its access to cheap credit, subsidies, preferable treatment in the allocation of scarce resources such as foreign exchange and political and other non-economic pressures, which not only constitute a drain on the governments resources, but also hinders the efficient allocation of scarce financial and human resources. The pressure to keep non-performing parastatals afloat also constitutes a major source of fiscal deficits and increased external borrowing, which feeds the unsustainable external debt of most countries especially in Africa. The basic question relating to the benefits of privatization is the following: is a country better off or worse off when its Government divests itself of a public enterprise. In a synthesis of theoretical literature, Galal et.al (1994) reached the following conclusions: 1. small private enterprises facing competitive output and input markets are unequivocally superior to large public enterprises facing monopoly markets; 2. small public enterprises facing competitive output and input markets can do no better than private enterprises in the same circumstances, but can do considerably worse. 3. in large monopoly markets the predictions of theory are ambiguous, depending on the institutional details assumed. According to Galal et.al (op.cit), the first statement is irrelevant for policy purposes because it does not reflect an available choice. The second proposition justifies mass privatization programs in formerly socialist economies, where at least 80 percent of the economy was in state hands. It is of minor importance in most mixed economies where state participation is 10 percent and below, and can be potentially divested. In such economies it is the last conclusion, concerning monopoly markets, which is critical.

Galal et.al summarized the findings of empirical research on the welfare impacts of privatization, carried out in a selected number of countries. The findings were summarized as follows. According to Boardman and Vining (1989), there is robust evidence that privatization improves efficiency. Boycko et.al (1993) concluded that there is universal consensus that privatization improves efficiency. Without exception, the empirical findings indicate that the same level of output could be produced at substantially lower cost if output were produced by the private sector rather than the public sector (Bennet and Johnson, 1979). Caves and Christensen (1980) drew different conclusions from the foregoing, stating that "contrary to what is predicted in the property rights literature, we find no evidence of inferior efficiency performance by the government owned railroad....public ownership is not inherently less efficient than private ownership....the oft-noted inefficiency of government enterprises stems from their isolation from effective compensation rather than their public ownership per se."

Two works adjusted for market structure, came up with the following observations: the evidence suggests an edge for the private sector, but the results vary considerably across sectors. In sectors where there is some evidence of superior public efficiency (water and electricity), there is limited competition or the private firms are highly regulated (Boardman and Vining, 1989). The other conclusion by Millward (1988), states that there is no evidence of a statistically satisfactory kind to suggest that public enterprises in LDCs have a lower level of technical efficiency than private firms operating at the same level of operation. These divergent views are reconciled by acknowledging differences in sectors of operation and the nature of the enterprises being compared, whether they are private or public monopolies or they are natural monopolies.

Another area of constant discussion relates to the privatization of natural monopolies, especially in public utilities and services, including energy and telecommunications.<sup>3</sup> There are mainly three alternative policy options with regard to the treatment of natural monopoly: to introduce competition for franchise; actual regulation (under private ownership or after privatization); or continuing as a public enterprise (Kip Visousi et.al. 1995). We will comment on the latter two. In countries such as the United States where public ownership is minimal (under 2 percent of GDP) most natural monopolies are privately owned, and then controlled by a regulatory agency that must approve the prices that the monopolist will charge. A key goal is to have prices that are not unduly discriminatory to both consumers and producers but that permit total revenues to cover total costs. The other alternative is that of leaving the monopoly as a public enterprise. The government would then employ some form of self regulation and "direct" managers to maximize economic surplus.

Proponents of this strategy hold that natural monopolies, will be better off left in the hands of the Government, as the interest of the public will not be best served any better if they are in private hands, as moving them into private hands will not improve the situation but would only make the private monopolist price the service to maximize profits to the peril of the consumers. While in principle this may appear to be a reasonable solution, it has practical difficulties related to self regulation and it does not hold when you consider the efficiency gains to be realized by the private monopolist's motivation to keep operating costs at a minimum. The other gain from

the privatization of a natural monopoly is that outside the government machinery, the firm will be better regulated for the benefit of the consumers, than when the management are government insiders. In most cases this situation leads to constant pressure for higher prices or tariffs which receive a sympathetic ear from the government, while the company continues to deliver a sub-optimal service.

### **Macroeconomic considerations**

The major macroeconomic consideration, and which is important in the context of overall economic reform, is the direct effect of privatization on public finances. The immediate effect of an asset sale by the government is an increase in revenues or a reduction in the budget deficit, with the impact being especially greater in cases where the major participants in the acquisition of the assets are foreign investors bringing in "new resources". Galal et. al. (1994) have confirmed these outcomes using their study of the Mexican experience, which suggested that seemingly unattractive, money--losing, or marginally profitable public enterprises can be sold, often for large sums of money; that even if they do not sell for large sums of money, they can still make a substantial positive contribution to the fiscal situation; and that the aggregate sums can be large enough to make a real difference at the macroeconomic level.

A related advantage results from the gains in cutting subsidies. The non-commercial objectives of most state owned enterprises usually require that their operations be subsidized by the state. This is especially prevalent in economies dominated by statutory marketing agencies or other government entities. The privatization of such firms or their liquidation as a result of the liberalization of marketing channels immediately returns to the state treasury all such outlays--removing the state owned enterprises off the back of the government so to speak. The savings are usually substantial depending on the extent of public sector participation in the economy. Another positive macroeconomic outcome from privatization is the very act of removing business ventures from the day to day activities of the Government. This allows the government to withdraw to areas in which it has or it is expected to have a comparative advantage, that is, the provision of social capital and basic human services including health and education and generally developing the policies to create the enabling environment for sustained growth. Most governments face serious resources constraints just providing the basic services referred to above, even before they take on the task of running business enterprises. Privatization permits governments to focus their energy on a selected number of activities and perform them effectively.

What should be expected from pursuing a private sector led development strategy? The ultimate goal of any development strategy is the achievement of economic growth and the improvement of the livelihoods of the population. The growth impacts of private investment and privatization have been well documented. Lessons and experience gained from the rapidly developing countries indicates that there is a close relationship between private investment and GDP growth (Chibber and Leechor, 1993). An important characteristic of the rapid development in Southeast Asia was the substantial government support and encouragement for private investment and generally private ownership. The Newly Industrialised Countries (NICs) supported private entrepreneurship for two reasons: because private entrepreneurs have a clear objective of increasing profitability, and new investments are stimulated because the presence of a large number of private entrepreneurs reduces the risks associated with undertaking economic activities. There is generally the misconception that the Asian tigers grew out of a large dose of government intervention in their economies. This, however, hides the fact that the nature of intervention was positive and intended to advance the activities of the private sector and not one of confrontation with the private sector. Many other countries whose governments also intervened in their economies did not achieve similar results.

### **Sequencing and Pace of Privatization**

Another question which is a source of continuous debate is the pace of privatization. Arguments abound for and against rapid transition to private sector based economy. Harvard economist Jeffrey Sachs,<sup>4</sup> who has done substantive work on the transition economies concluded that the pace of privatization depends on various factors including the extent of public sector participation and the position of the country in the transition process. As argued by Sachs, a country with a large share of state enterprises should move to privatize quickly because continued ownership or participation by the state in one form or another, in the name of gradual privatization will usually attract irresponsible behavior from the care-taker management and workers, who may actually strip the enterprises of their income and assets. The workers with full knowledge of the impending privatization and possible retrenchment resort to even larger pressures for wage increases and other activities including selling the companies' machinery.

The other reason advanced for rapid privatization is related to the first one in that in the state run agencies there are no clear owners interested in the long term profitability of the corporation. The management and workers do not therefore make any important investment decisions involving increased longer term inflows to the corporation in the later years. According to Sachs, the best bet for the current management and workers is

to maximize their own current income at all costs. Furthermore, if privatization proceeds too slowly, there is the risk that the managers and workers within the enterprise might themselves paralyze the enterprise's privatization. They raise the pressure to have the enterprises "given to them" or argue for some kind of sub-optimal management buy out.

The other reason is simply one of logistics and timing. While a country with a small state sector will have the time and luxury to carry out meticulous analyses and careful valuations of each enterprise before privatizing it, a country with a state sector exceeding 80 percent of the economy or hundreds of firms cannot afford that procedure.<sup>5</sup> The valuation process is not only time consuming but can prove an expensive undertaking by the Government in terms of consultants fees and the very inertia related issues raised in the foregoing discussion. By the time the analysis is completed, usually there will be nothing left of the enterprise to privatize. Most of the economies in transition which are involved in the privatization process lack the specialized expertise to carry out valuations of this nature and invariably the experts will have to come from outside at excessive cost.

These arguments are consistent with the conclusions of Kortba and Svejner (1993), in their review of the privatization exercise in the Czech and Slovak Republics. The two republics experience, they conclude, have been quite successful, given the extent of the participation of the State sector in the economy (98% of assets in 1989), and the problems associated with forty years of virtually no experience with private ownership, both at the Government and entrepreneurial levels. The new Governments assembled and rapidly implemented three complementary privatization programs that transferred state ownership to individuals, groups and the population at large. The design and implementation of the program were largely helped by the determination of the Government to the goal of privatization. Numerous problems were experienced, but the Government used its resolve to solve the problems, bringing to the process an atmosphere of credibility and trust. This created and maintained the much needed public support for the program.

Countries like China, chose a gradualist path in their transition to a market economy. China's experience markedly differs from that of the rapid or mass privatization approaches adopted in eastern Europe, though the results are similar. It needs to be pointed out that China's experience is not one of purely privatization of public enterprises, but of a full scale reform and transition process from a totally state run economy based on a communist ideology. As discussed by Gelb et.al (1993), China's reforms had been introduced on sectoral lines and were usually locally differentiated. China's implementation of the reforms was carried out in four phases. Phase I--between 1978 and 1983 covering mainly: agriculture prices and market reforms; experimental contracting of land use; and legalizing joint ventures in industry. Phase II--between 1984-88, during which policy measures included: elimination of guiding prices and quotas; tax reforms; authorization of village enterprises; the passing of the enterprise law; and exchange rate liberalization measures, resulting in the real depreciation of the *yuan*. During these phases the country was reforming its commercial system, deregulating entry and exit of firms, and privatising state enterprises. By 1985, 75% of state commercial enterprises were sold or leased to the public. Phases III and IV completed the reform process between 1989 and 1992, including the creation of stock markets and new operating mechanisms to increase autonomy of state enterprises.

China's achievements in the transition to a market economy has been positive to a large extent, as reflected by the rising productivity both in agriculture and industry. China's per capita income doubled between 1980 and 1990.<sup>6</sup> Returns have increased with increased marketization and the entry of non-state sector enterprises has been instrumental in creating domestic competition. China has experienced increased flows of investment from outside, from multinational corporations as well as the overseas Chinese community, made possible by the new open door policy.

China's experience and success with gradualism does not contradict Sach's contention that countries with large private sectors proceed rapidly with privatization. It mainly reflects the different environment and historical precedent that China faced. Ultimately, the pace of privatization should follow individual country circumstances. Some countries may need to move faster than others. In general, privatization should be implemented after a relatively high level of macro economic stabilization and liberalization, and countries will choose the moment they feel most ready to take the next step. Countries need to avoid being overcautious, as is seen in most policy recommendations. It should be pointed out many countries in Africa, for example, moved from systems emphasizing private sector production in the sixties--Zambia, Ghana, Tanzania, Uganda among others--to nationalized or public sector production of goods and services in the seventies. These countries have the institutional memory to move ahead with privatization rather quickly to carry on from where they left in the sixties. In our opinion, they could be better placed to make the transition to market economies than countries from the former Soviet block which have had nationalized production systems for more than 50 years. This is a feature that the privatizing African countries could use to their advantage.

## **Evolution of the Zambian Economy and Emergence of Public Enterprises**

### **Background and Ownership Pattern in the 60s and 70s**

Zambia, located in southern Africa, boasts vast natural resources of which the most prominent are its minerals, mainly copper. Other metals produced include cobalt, zinc, and emeralds. Apart from minerals, the country has abundant land and water resources. Nearly all the land area is suitable for crops or forestry plantations. The water resources include three lakes, Kariba, Bangweulu and Mweru, and four major rivers, the Zambezi, Kafue, Luangwa and Chambeshi. Agriculture is also significant though it has remained below its potential. There is also a substantive and until recently highly protected manufacturing sector.

Zambia was a fairly prosperous colonial economy with a well established private sector in an open, market oriented economy, dominated mainly by expatriate business interests, multinational corporations and commercial farmers. The copper industry which was the mainstay of the economy was under the control of two large mining groups--Anglo American Corporation and Roan Selection Trust. State participation in the economy at the time was limited to very few activities such as railways, electricity and water. At independence in 1964, Zambia inherited a buoyant and highly specialized mining economy. In the sixties and seventies, the country experienced rapid economic growth stimulated by government expenditure on infrastructure and services, and investment in import substituting manufacturing enterprises.

Following the unilateral declaration of independence (UDI) in neighboring Southern Rhodesia (now Zimbabwe) in 1965, investments in local manufacturing expanded further as a number of companies that previously supplied Zambia from Zimbabwe set up operations locally in a bid to protect their markets in Zambia, after the imposition of trade sanctions on Rhodesia by the UN. As a result of a combination of these factors, growth in the first decade after independence was comparatively high. For example, between 1966 and 1970, GDP growth averaged 11.4 percent, and for the entire period 1966-76, GDP growth averaged 8.7 percent (CSO, Zambia).

### **Rise of State Intervention in the Economy**

State intervention in the economy began in 1968 with what was commonly referred to as the Mulungushi Reforms. In a political speech at Mulungushi, the then President of Zambia Kenneth Kaunda announced a program of nationalization of private owned companies. The government nationalized a wide range of commercial activities ranging from retail shops to meat packing plants, and quarrying operations. Altogether 28 companies were affected by the measures. This did not include the copper mines. The Mulungushi reforms were quickly followed by another series of reforms the following year known as the Matero reforms ( named after the Lusaka suburb in which the policy was announced) at which the measures to nationalize the mining companies were announced.

To a large extent, the 1969 measures had been anticipated given the dominant role of the mining sector in the Zambian economy.<sup>7</sup> A number of observers had regarded the 1968 reforms as the preamble to the more important nationalization of the mining companies. By the end of 1969, parastatal activities covered all aspects of business including: mining; agriculture; hotels and tourism; milling; brewing; housing provision and construction; transportation including airlines and passenger bus services; electricity and water; timber and wood products; and bakeries. A number of the new ventures established by parastatals were jointly owned with foreign partners who mainly wanted the State to provide a protected market either through a ban on the importation of competing goods or the imposition of prohibitive tariffs.

With the take over of the mines, private sector participation in the economy virtually ceased, with the exception of a few activities and mainly in the banking sector. Barclays Bank, Standard Bank and Grindlays Bank--all foreign private banks were dominant in the commercial banking sector. The government fell short of nationalizing the foreign owned commercial banks when negotiations collapsed, but managed to set up three government banks (Jones, 1980), including the Zambia National Commercial Bank (ZNCB). Within a short period, ZNCB grew to become the largest bank mainly because it had a monopoly of the banking business from the parastatal firms. Another area where the private sector remained dominant was agriculture. Although the State had acquired considerable properties in the agricultural sector, the performance of State farms was dismal. The government, therefore, had no option but to rely on the few mainly expatriate commercial farmers for the supply of food, especially for the urban population. Because further expansion could no longer be expected from private sector initiative after 1968, the emergent parastatal sector took upon itself an even greater mission. In the mid 1960s, the parastatal sector contributed only 14 percent of the country's GDP, but by 1980, more than 80 percent of the economy was virtually run by the Government.

## **What Was Wrong With the Parastatal Strategy?**

Like elsewhere, Zambian state firms failed to perform for a variety of reasons including: the application of inappropriate technology; total dependence on processing of imported raw materials; inexperienced management; misappropriation of resources by officials appointed by governments to run them; and operation in monopolistic environments with no competition. The implication of this was that public enterprises were typically inefficient, which affected their financial viability, in turn requiring the government to subsidize their operations. It should, however, be noted that state participation in economies at that time was widely accepted as the way forward. Most countries were nationalizing some aspect of their economic activity and even the World Bank looked at this approach favorably.

On the macro front, the proliferation of public enterprises had transformed the country into a large public sector, a feature well reflected in the government's expenditure and consumption patterns. The extended public sector not only implied large central government budget outlays, but also imposed a severe burden on a government which already had extremely limited human resources for economic policy formulation and management. The total effect of this level of state participation on the macroeconomic level was massive government failure on both the provision of essential public services and the new commercial activities due to the thin spread of qualified staff.<sup>8</sup> The large government outlays dictated by the structure of the economy entailed a considerable level of deficit financing. The fiscal deficit increased progressively from K 39 million in 1965, to peak at K 3.5 billion in 1988.<sup>9</sup> The principal source of the deficit was the subsidy to public enterprises.

The pattern of development pursued also created a number of economic, political and social obstacles, which would later prove detrimental to any reform efforts by the Government. On the economic front, the obstacle which arose was that since the structure of the economy was such that productive activities were dominated by public enterprises, attempts to narrow the deficit during stabilization programs, resulted in considerable reduction in capacity utilization and output in all sectors, and falling GDP. This was because there was no strong private sector to pick up the slack. The highly protected manufacturing industry, did not help in attaining low cost production. On the political side, the developments were: the rise of the mining sector which pushed to the fore powerful mining trade unions, and of subsidized and mainly urban social services, which created influential urban political constituencies, and who would subsequently affect the direction of economic policy and reform.<sup>10</sup> These groups were in a position to lose the most from any significant economic reforms, such as contractionary expenditure or tight fiscal and monetary policies that would have meant restraining the growth of urban wages and cutting of food subsidies.

Zambia has, since the early 1980s made various attempts at stabilization and adjustment, including the adjustment efforts of 1983-86; the 1987-89 adjustment from "own resources"; and the reform measures commenced in 1992. The programs invariably were intended to achieve the following: 1) provide adequate economic incentives for the production of agricultural and manufactured exports; 2) increased international competitiveness of the economy; and 3) the allocation of resources in line with the above objectives. The adjustment program started in 1992 represented a major departure from previous reform efforts, by incorporating the implementation of a major privatization program, which is the subject of this paper.

## **Privatization of Public Enterprises**

### **The Rethink Of State Ownership**

By the middle of the 1970s, the flaws in Zambia's strategy of State ownership had started to show. With the onset of the oil crisis of 1973 Zambia, a land-locked country, found itself with a huge oil bill to pay. 1973 also marked the peak in Zambia's copper production. The oil crisis led OECD countries to search for alternatives to most imported raw materials. Copper was vulnerable to this due to several factors such as miniaturization, recycling and presence of alternatives such as fibre glass and wireless transmission. The result of this was that, while Zambia's need for foreign currency had gone up due to the huge import dependent parastatal sector, as well as, the high oil bill, its ability to earn foreign exchange was rapidly declining. This, resulted in a crisis whereby industries were unable to sustain reasonable levels of capacity utilization due to lack of raw materials and spare parts. Foreign currency had to be rationed, but, even amongst the preferred parastatal companies priorities had to be made, leaving a number of them in very precarious situations. What was particularly disastrous about the situation was that, parastatals were not expected to adjust their employment levels to those commensurate with their level of operations. They had to carry all the workers inspite of the reduced volume of activity--this was regarded as social responsibility.

The first response to the emerging crisis was in the form of reforms. In 1979, Zambia launched a reform of the Zambia Industrial and Mining Corporation (ZIMCO)--the main parastatal holding company. Under the 1979 reforms the parastatals were de-linked from direct supervision by sector ministries. Instead, directorates were

created at ZIMCO each of which was to be responsible for supervising companies in particular sectors, such as transport, agriculture, tourism etc. In 1986 and 1988 IDA funded a study to look into the operations of 12 parastatal companies and determine how their operations could be improved. The study recommended additional reform measures to improve efficiency and profitability of the enterprises, including emphasis on new business practices such as economic pricing of goods and services.

Kaunga (1994) points out that the landmark on privatization was made by then President Kaunda at the official opening of the Fifth Extraordinary Session of the National Council of the United National Independence Party in May, 1990 at which he announced the government's decision to "devolve more economic power to the Zambian people through a scheme by which the State would sell its interest in state enterprises to the general public". According to the statement, the State was to offer up to 40% of its shares in public entities like, Zambia Railways (ZR) and Zambia Electricity Supply Corporation (ZESCO) and up to 49% of its shareholding in mining, industrial and commercial enterprises. In his budget address in November, 1990, the then Minister of Finance, Mr. G.G. Chigaga expanded on the Policy of Privatization by stating that: "In addition, the Party and its government have decided in principle to sell off some parastatal companies. The modalities for sale are being studied, including the possibility of selling some shares to workers and members of the public".

While the government of the time was moving towards privatization, it is now widely accepted that the real turn around occurred in 1991, when Zambia returned to multi-party politics. The elections held in the same year resulted in a change of government to the Movement for Multi Party Democracy (MMD) under the leadership of President Chiluba. The new President when addressing the donor community soon after assuming power in 1991 said: "As far as the privatization program is concerned there is no sacred lamb. In other words, the government is committed to total privatization of the parastatal sector." In addition, the President vested responsibility for overseeing the privatization program in the Ministry of Commerce, Trade and Industry. The new government's position was further concretized by the new Minister of Finance, who in his January 31st, 1992 Budget address said "The MMD government has made clear its intention to promote the private sector and divest itself of investment in parastatals. In this regard, privatization will proceed expeditiously and the revenues generated will be put in a special fund to supplement the government capital budget".

### **Institutional Framework For Privatization**

Following the announcement of the policy on privatization in May 1990, the government in September 1990, set up a Task Force on privatization. The Task Force which submitted its report to the Minister of Finance in January 1991, recommended the creation of two organs:

- (i) Steering Committee on Privatization; and
- (ii) Technical Committee on Privatization.

The Steering Committee was to be responsible for policy issues on Privatization while the Technical Committee was to be responsible for the actual privatization activities. The Technical Committee staff were drawn from within the parastatal sector. By June 1991, the Steering Committee had identified 10 companies for outright sale to the private sector.

The coming into power of the MMD government on 31st October, 1991 put the privatization program on a new footing. The new government was elected on the platform of strong support for private enterprise. Immediately after assuming office, President Chiluba made it clear that all parastatals would be put up for sale. To facilitate the process, the government moved quickly to pass the necessary legislation. In July, 1992, the Privatization Act (No:21 of 1992) was passed by Parliament. This Act established the Zambia Privatization Agency (ZPA) as the sole institution responsible for the divestiture of state enterprises. ZPA was to be governed by a Board of Directors to be drawn from the Public and Private Sectors. The agency was granted autonomy to determine how enterprises were to be privatized and the prices to be paid for them. Cabinets' role was confined to approval of the divestiture sequence. The Zambia Privatization Act lists the following, as modes of privatization that can be employed in the divestiture process:

- (i) Public offering of shares;
- (ii) Private sale via negotiated and competitive bids;
- (iii) Dilution of government holding;
- (iv) Sale of assets;
- (v) Re-organization of State-owned enterprises before sale of whole or part;
- (vi) Management/employee buy out;
- (vii) Lease and management contracts; and
- (viii) Any other method the agency may consider.

Following the enactment of the Act the ZPA Board was appointed and it set itself to work by appointing officers to run the agency. The old technical committee was disbanded. The first task for ZPA was to draw up a long-term Divestiture Sequencing Plan for approval by Cabinet. This comprised seven tranches, the first of which comprised 20 mainly small companies which could be easily analyzed and disposed of through trade sales. These are: Eagle Travel Limited; Poultry Processing Company, Autocare Limited; AFE Limited; Coolwell Systems Limited; Zuva Zambia Limited; Prime Marble Products; General Pharmaceuticals; Zambia Malting Limited; Crushed Stores Sales Ltd.; Consolidated Tyre Services; Mwinilunga Canneries; Nkwazi Manufacturing Ltd.; Zambia Clay Industries Ltd.; Cleanwell Dry Cleaners Ltd.; Monarch Zambia Ltd; Zambia Drum and Can; Zambia Ceramics Ltd.; and Norgroup Plastics Ltd.

While the Zambia Privatization Act and the creation of the agency can be viewed as the most important aspects of the institutional set-up required to start the program, there were a number of other measures that had to be taken before the program could start. Most importantly, a large number of legislative amendments were made in order to make it possible to sell some of the state-owned enterprises, most of which also owned other assets including land and residential properties.<sup>11</sup> A number of these were statutory bodies, established under their special acts of parliament rather than being governed by the companies act. To facilitate for the wider disposal of State-owned companies, the Zambia Privatization Act provided for the sale of a percentage of the shares of some companies, especially the large ones, to the public through the Stock Exchange. Since no Stock Exchange existed by 1992, one of the most important things that had to be done, was to pass the Zambia Securities Act. The Securities and Exchange Commission was established in December, 1993 and the Lusaka Stock Exchange in 1994. UNDP provided the financing for technical work required to effect most of these legislative changes under a Privatization and Industrial Reform Program covering institutional reform and capacity building in the major reform areas and sectors of the economy, including: privatization, law reform, capital markets development and public sector reform.

From 1995, things moved quickly so that by 1996 the World Bank was able to comment on the program as follows: "Zambia has the most successful privatization program to date and the experience there offers many examples of best practice" (World Bank, 1995). The World Bank report illustrated that since 1995, progress has indeed been very significant as shown in Table 1.

**Table 1 Privatization Program Status as at end October, 1996**

	Dec. 1994	Mar. 1995	June 1995	Sept. 1995	Dec. 1995	Mar 1996	June 1996
<b>Completed Privatization Deals</b>	15	16	21	41	60	79	97
<b>Negotiations completed</b>	-	5	3	4	12	12	23
<b>Heads of Agreement signed.</b>	-	-	11	38	30	27	17
<b>Company Units privatized</b>	15	21	35	86	102	118	137

Source: World Bank, Findings, October 1996, Page 1.

Apart from the UNDP support noted above, many other agencies provided and continue to provide support to Zambia's privatization program. The World Bank in June 1992, provided assistance through the Privatization and Industrial Reform Credit. This was followed by the second Privatization and Industrial Reform Credit in June 1993. These balance of payments operations were tied to conditionalities relating to industrial reform and privatization. A lot of support to the Zambia Privatization Agency also came through bilateral agencies, such as, USAID, ODA, GTZ, NORAD, and DANIDA. This support was mainly in the form of provision of technical experts to assist ZPA in the technical evaluation of companies to be privatized, provision of equipment, such as, computers and the training of personnel. The ZPA also benefited from capacity building workshops and short courses.

One aspect of institutional set up that requires mention here was the problem posed by the continued existence of the Zambia Industrial and Mining Corporation (ZIMCO), the holding company for all the parastatal firms in Zambia. ZIMCO controlled a number of sub-holding companies each of which was responsible for investments in particular sectors, such as the Industrial Development Corporation (INDECO) which was responsible for

investments in manufacturing, and the National Hotels Development Corporation (NHDC) which catered for hotels and lodges. Upon the start of the privatization program all sub-holding companies like INDECO were disbanded and the parastatals came under the direct supervision of ZIMCO. When the sales of tranche 1 companies started in 1993 ZIMCO immediately became a very vocal critic of ZPA. It opposed most of the negotiated prices for the sale of the companies arguing that the companies were deliberately undervalued. ZIMCO contended that it was the sole representative of the owners of the parastatals, namely the government, and therefore demanded representation at all sale negotiations.

ZIMCO was generally reluctant to deal with ZPA and yet companies could not be disposed of without the participation of the holding company. To resolve this problem government was in 1995 forced to close down ZIMCO itself. This act removed a major bottleneck to the privatization process. The closure of ZIMCO, however, led to new problems. With the removal of a supervisory authority most parastatal managers were now their own bosses. This autonomy, unfortunately, posed a serious threat to the companies they managed. Given that all managers were acutely aware of the fates to befall their companies in the near future and realizing that there could be no future for them in the privatized companies, the managers resorted to self enrichment. The problem of asset stripping, in the context of our earlier discussion, became a major new concern.

### **The Process Of Divestiture Of Companies**

Once the Zambia Privatization Agency had started to work the first step in the privatization process was tranching. A tranche is defined as a group of companies selected to be privatized within a given period of time. The selection of companies to various tranches in Zambia has not been without controversy, and there has been a shifting of companies between tranches over time. The first tranche as already noted, consisted of very small companies that were selected mainly for a test run i.e. to test how the process of privatization can be implemented. Given that privatization was being attempted for the first time and the privatization agency had not yet assembled a cadre of experts in evaluation, this may have been a prudent action on the part of the government. Although the tranches were proposed by ZPA, they were ultimately approved by Cabinet, as required by the Privatization Act. The process of privatization follows these steps:

1. Tranching - approved by Cabinet;
2. Technical and financial evaluation of company to fix the price and recommend the mode of divestiture - done by Consultants;
3. ZPA decision on price and mode of divestiture;
4. Advertising and opening up of competitive bidding - by ZPA;
5. Evaluation and short-listing of bidders - done by ZPA;
6. Negotiations - done by independent teams;
7. Signing of Heads of Agreement/Memorandum of sale by the Minister of Finance.

Once a tranche of companies becomes eligible for privatization the ZPA undertakes detailed evaluation of all aspects of the company with the assistance of independent consultants. These studies look at the state of equipment and buildings, the production process, the work force, the industry and the financial standing of the company. These studies establish the value of the company which ZPA can use as a bench-mark against bids to be submitted by intending buyers. The studies involve substantial financial outlays which in many case were met by donors. From the report of the consultants, ZPA staff produce a prospectus which is distributed to investors interested in the company. Prospective investors make their own evaluation and on the basis of which they decide to bid for the company and for how much.

In the interest of transparency, the privatization process involves extensive public information work and ZPA spends substantially on advertisements to call for consultants, advertise companies ready for sale, and inform the public of the progress of the program. Seminars are held with the public to sensitize them on the benefits of the program, as well as with the business community whose participation is crucial to the success of the program. The budget for advertisements becomes particularly high when adverts have to be put in the foreign media during the sale of big companies. In the case of Zambia, the funding for these activities was provided through the support of USAID to the program.

In its evaluation, ZPA ranks bidders on the basis of the business development plans being proposed for the company, as well as the price being offered. In reality, the business plan carries more weight because the overall benefits to the nation can only be realized if a company is sold to someone who is able to sustain its operations as well as expand it. Other criteria used included issues such as competition, job retention or creation, expansion of productive capacity, and quality of management. The evaluation of the top three bidders together with the reports of the consultants and prospectus are given to a team of negotiators who finalize recommendations on who will purchase the company.

ZPA uses independent negotiators mainly drawn from the Zambian public, but are usually people of an appreciable level of competence in matters relating to business and finance. Each team is composed of a chairman, a lawyer and an official from ZPA whose main role is to record the proceedings of the meetings. A negotiating team could be larger than the three people mentioned depending on the complexity of the company to be sold. A representative of ZIMCO, the holding company, was also usually a member of the negotiating team. The negotiating team invites the highest placed bidder first and tries to improve the offer and the terms of purchase. If there is agreement on major issues, negotiations can be completed very quickly. Where the highest placed bidder does not seem to be willing to proceed with the offer negotiators open discussions with other short-listed bidders. Once negotiations are concluded, the results are presented to the ZPA Board for approval. After ZPA Board approval, the signature of the Minister of Finance concludes the deal. The Privatization Act requires the ZPA to produce two reports: i) a six monthly report of its activities and ii) a report of companies sold, giving the names of the bidders, buyers and prices.

The Zambia Privatization Act provides for two types of payment for the sale of companies; deferred payment and cash sale. The deferred payment method provides for the payment of a deposit, with the balance spread over a period of time in the future. This method was developed to cater for Zambian individuals who may want to purchase State owned enterprises but did not immediately have the requisite funds.<sup>12</sup> This method is not available to Zambian owned/controlled companies that may want to participate in the privatization process. The cash sale method is applied to all other categories of bidders except management buy-outs. Bidders, so far, have included Zambian individuals, management buy out teams, Zambian companies and foreign companies. Within the Privatization Act, provision is made for current minority shareholders in parastatals to exercise pre-emptive rights. Such minority shareholders have the right of first refusal before a company can be put to public sale. By October, 1996 fourteen companies had been sold on the basis of pre-emptive rights. A number of large companies that had been established with foreign partners who mainly provided the critical technology were disposed of using this method and includes: Chilanga Cement Limited; Zambia Breweries; Zambia Sugar Company; Kapiri Glass Products; Kafironda Limited; Agip (Zambia) Limited; B.P. (Zambia) Limited; Zambia Refiners; Lublend; National Breweries; Mpongwe Development Company; and Nanga Farms Limited.

Another method that ZPA has employed to end state participation in the economy has been liquidation. This method is preferred where the company is so run down that it would be difficult to turn it into a going concern or to find a buyer. Fifteen companies were liquidated under this procedure, including: Zambia Housing Development Fund; Buildwell Construction; Mfulira Hotel; Redirection placement; Africa Bound Limited; Zambia State Property; Zambia State Security Limited; Lakes Fisheries; City Radio; Mwinilunga Canneries; Anros Industries; and EC Milling.

Two companies--United Bus Company (UBZ) and Zambia Airways were also liquidated but this action was taken outside the ZPA process. While closure of companies looks harsh (especially due to employment loss) it may well be asked what could have become of these companies if they had been allowed to continue in the light of their dismal performance and the government's decision to stop providing subsidies to such companies. The case of the two transport companies cited above make an interesting point. After Zambia Airways went into liquidation the government allowed the registration of private airlines. The result has been the establishment of Aero Zambia, Zambia Express, Eastern Air and Stabo Air. Instead of one airline, Zambia now has four airlines each of which operates without government financing or subsidies. In the case of the United Bus Company liquidation, the void was quickly filled by private sector passenger transport operators.<sup>13</sup> The gains from the improved supply of buses in terms of new employment opportunities for workers associated with the transport sector far exceed the benefits of resuscitating UBZ, to maintain a few hundred jobs.

Another important issue in the privatization program in Zambia has been how to increase public participation in ownership of the enterprises. Any privatization program that excludes locals from taking significant stakes in the newly privatized companies risks being branded as a move to reintroduce foreign control or neo-colonialism. This danger was real for Zambia because of the low levels of incomes and savings which virtually excluded most of the local Zambians from participating in the acquisition of property. The previous socialist policies had also prevented the development of an indigenous business class since accumulation of wealth was viewed negatively. In fact a firm growing beyond a certain threshold was likely to fall prey to nationalization. Added to this was that after many years of state harassment the business community had withdrawn into a cocoon. They had not, like in other countries, developed approaches towards cooperation through joint stock companies but were, instead, mainly sole owner or family controlled businesses. The institutions necessary for fostering that kind of cooperation, such as, stock exchanges had also not been developed.

In order to address this issue, the Privatization Act provided for the creation of the Zambia Privatization Trust Fund. The Trust Fund was established in 1994 and its function is to warehouse shares reserved for floatation to the general public. A certain proportion of shares (usually 30 percent of the share capital) are transferred to the Trust Fund where they are warehoused until such time that they will be sold to the public on the Stock Exchange. By October, 1996 sixteen companies were targeted for eventual floatation on the Stock Exchange as

a way of facilitating for wider public ownership. These companies are: Chilanga Cement; Rothmans; Zambia Sugar; National Breweries; Northern Breweries; Zambia Breweries; Zamhort; Lintco; Choma Milling; Refined Oil Products; Pamodzi Hotel; BP (Zambia); AGIP; Kafironda; Nanga Farms; and Mpongwe Development Company Limited.

There has also been a number of companies that have been disposed of through the management buy-out approach. Management buy-out teams have the right to use the deferred payment method. Due to this provision, many corporate bidders (who are otherwise not allowed to participate in Management Buy Outs) are known to have entered into joint ventures with Management buy out teams primarily to benefit from deferred payments terms.

In terms of the overall divestiture program, Table 2 gives a summary of the companies privatized as at end of October, 1996.

**Table 2: Summary of Privatization Transactions as at 30 September, 1996**

	Category	No Sold
1.	Companies sold to Zambian individuals through competitive bidding.	18
2.	Companies sold to Zambian companies through competitive bidding.	41
3.	Companies handed back to previous owners (Zambian companies).	13
4.	Companies sold to Management buy-out teams.	16
5.	Companies sold to foreigners with Zambian minority participation.	5
6.	Companies sold to foreigners on the basis of Pre-emptive rights (outside Zambia Privatization Agency (ZPA) control)	14
7.	Companies sold to foreigners on competitive bid basis.	16
8.	Winds-up and liquidation.	12
9.	Companies in which public flotation has/will take place as a result of Zambia Privatization Agency (ZPA) efforts.	16

Source: Zambia Privatization Agency (ZPA) Press Release, in *Times of Zambia* - 3 October, 1996.

### **Evaluation of the Privatization Program**

Evaluating the direct impacts of privatization usually poses a problem in that the measures related to the privatization of public enterprises usually take place at the same time as economy wide liberalization measures (Adam, 1993). Evaluating the impact of privatization in Zambia poses a similar problem of trying to dissociate the effects of market liberalization and the change of ownership itself. The assessment of the privatization program will focus on a number of key indicators including the impact on the governments resources, divestiture timing, extent of participation by foreign investors and issues relating to the pricing of the assets and employment generation. These are highlighted in turn, beginning with some comments on assigning causality between general liberalization measures and privatization per se.

### **Privatization and Liberalization Effects**

Privatization has certainly been the driving force behind the changes and increased flow of investments into the country. The earlier privatisations such as those of Chilanga Cement, Zambia Breweries and Zambia Sugar Co. can be used to illustrate these developments. In the Chilanga Cement Privatization, Commonwealth Development Corporation (CDC) increased their shareholding and the company was the first to be listed on the Zambia Stock Exchange. Chilanga has since received substantial new investments and is on the verge of expanding its operations. The privatization of Zambia Breweries has also proved a successful operation. Both these companies have also gone to the higher phase of offering shares to the Public, the latest being Zambia

Breweries through the Zambia Privatization Trust Fund. The most elaborate case has, however, been that of Zambia Sugar Company, which was bought by the UK firm Tate and Lyle and CDC, with the balance of the shares staked for public floatation.<sup>14</sup> Zambia Sugar Co. has received an injection of USD 28 million since Tate and Lyle, who are the original owners, took over in 1995. Additional investments of up to USD 40 million are planned. Production has risen from 120,000 tonnes in the early nineties to over 170,000 tonnes presently (Institutional Investor, 1997). Zambia Sugar has also started exporting sugar to Europe and neighbouring countries. The opening up of the economy that took place in Zambia has also attracted a lot of new investments and foreign investors outside those seeking to purchase parastatal companies. The most important of these were South African investors. These included groups of small investors in trade and agriculture. Many small-scale commercial farmers, were moving out of South Africa because of land scarcity and unfavorable weather, to try their luck in Zambia which was introducing similar incentives as in their home country, but with more abundant land and water resources. There has also been an active exchange of business portfolios amongst private sector investors than is often acknowledged. For example, LONRHO has concluded the sale of one of the largest hotels on the Copperbelt. Some other large sub-regional holding companies like Trans-Zambezi have been increasing their stakes in the Zambian economy. One negative observation has been that many small investors, especially from South Africa had been attracted to Zambia mainly because of its more liberal exchange control regulations compared to those obtaining in their home and neighboring countries. Some of them used short term high return investments such as bringing into the country scarce consumer goods, selling the goods and then externalizing the proceeds to some third country.

### **Divestiture Sequencing and Pace of Privatization**

In analyzing the divestiture sequence, it is important to observe that Zambia started with the small parastatal companies in Tranche 1, and hoped to work up into the larger ones in later tranches. The rationale for this approach was that the privatization agency would accumulate experience from the sale of smaller companies which would be valuable in handling bigger and more complex privatization exercises. While this approach has its merits, it has the disadvantage of starting the process of privatization on a low note. A big sale such as that of a telecommunication company--one of the most popular in most programs or a profitable mining operation, such as Ashanti Goldfields in Ghana creates the necessary confidence in the international business community that the country concerned is ready to do business. In looking at the pace of privatization, one should also consider the issue of competition for investors. Zambia is privatizing its parastatals at a time when many countries are putting up their state owned enterprises for sale, to basically the same investors. The investors will only extend their offers for so long, after which they would move on to Mozambique or the Slovak Republic, and perhaps, Vietnam. The competition for global funds is intense and this needs to be acknowledged.

### **Fiscal Impact**

One of the explicit goals from the privatization policy was to improve government finances from the proceeds of the sale of companies, and subsequently tax revenues from the expanded operations of the privatized firms. Modest gains have been made in that direction.<sup>15</sup> Total receipts from privatization amounted to about USD 25 million in 1995 when the process started in earnest. By the end of 1996, the program had generated about USD 200 million. Revenues are likely to jump higher with the privatization of the mines.<sup>16</sup> Revenues have also been boosted by the elimination of subsidies, which assisted the government to reduce the fiscal deficit to single digit levels in 1993 and cutting the primary deficit to close to zero in 1994.<sup>17</sup> It is anticipated that the government's fiscal position will improve even further with the successful privatization of the mines.

### **Extent of Foreign Participation**

Foreign participation is often used as a measure of the success of privatization programs. It is a yardstick for measuring the degree of confidence that the international investor community has in the business environment of the country concerned. Because every country is trying to attract foreign investors, various measures are taken to ensure that the investors are attracted to the countries. A critical element in any such measures are the removals of exchange controls. Investors who bring funds into the country want to be assured that they can take them out whenever they feel like doing so. Zambia guaranteed this with the initial liberalization measures taken in 1992. Other measures to attract foreign investors have included the Investment Act (No.19 of 1991)<sup>18</sup> under which a number of incentives are offered to investors.

In a big privatization program such as the one in Zambia, one is interested in knowing how much foreign investment is coming into the country, in what sectors these investments are going and the origins of the foreign investors. The overall picture that emerges is that foreign investors are moving into all aspects of the Zambian business. The Zambian program has attracted a cross section of investors from the USA, UK, India, South Africa, Germany, including companies such as Tate & Lyle, Unilever, Anglo American Corporation, Lonhro, Phelps Dodge, Clark Cotton among others (annex I gives the list of foreign investors, companies in

which they have acquired interests and sale funds paid for the assets). The major foreign investors so far have come from the United Kingdom mainly CDC (mostly through conversion of debt to equity and exercise of pre-emptive rights) and LONRHO, and South Africa mainly through Anglo American Corporation. It is significant to note that these three companies have had a presence in Zambia for a long time. They are what one may call old hands at doing business in Zambia. The decision to expand their shareholdings in companies where they were already participating was more of a natural thing to do. In the retail trade sector, the PEPCOR group of South Africa under its various trading names like Shoprite, PEP Stores and Smart Centre have acquired a number of former state shops in the major urban centres along the line of rail.

The Zambian program has not substantially benefited from participation by US companies, companies from other European countries, Asia, as well as South America. Participation by firms from the Nordic countries has been particularly low. As major donors to Zambia, participation by their firms would help transform the nature of their relationship with Zambia from one of dependence to one of mutual benefit. It is hoped that this will change as more blue chip companies in which they have particular expertise are put up for privatization. Zambia needs to specifically target some of these countries for possible investment in the new privatized companies, through increased media advertisements including on international television networks and external road shows.

### **Employment effects**

One of the key causes of resistance to early privatization has been the concern with loss of employment by the workers should the new owners not want to retain them. Even after the exercise, this remains a major source of criticism of the process by those that are against privatization. Actual experience has shown that in many of the companies that have been sold so far existing jobs have been preserved while in a number of others new jobs have been created. Job loss appears more acute at management levels where new owners prefer an infusion of fresh personnel, rather than at the middle or lower levels. The criticism that privatization has led to loss of jobs, therefore, can be mainly attributed to those companies that have been liquidated. The firms in the transport sector referred to above again offer good illustrations. The closure of the publicly owned transport firms released a large number of skilled workers including drivers, mechanics and other employees. The important thing to note is that the transport sector did not collapse. It is a handful of government operators who went under. Most of the workers were absorbed by the new entrants into the sectors. Admittedly, not all the workers could be absorbed, but some of these effects are the transitory costs of moving on to a more efficient system. These costs need to be weighed against the potential benefits of even larger employment opportunities from more efficient expanding private firms.

### **Privatization of Utilities and Monopolies**

Although there have not been any divestiture of the utilities, mostly monopolies such as the electric company and to some extent telecommunications, work is advanced on the privatization of Zamtel, the telecommunications utility, as well as the Copperbelt Power Company which distributes power on the Copperbelt.<sup>19</sup> How to treat these firms both during divestiture and after becomes important. Obviously, various modalities will be adopted depending on the analysis that would be done by the ZPA. Ultimately, ownership will be in private hands, to capture the efficiency gains discussed in 2.1 above. The problem will be how the economy will benefit from the least cost production--which requires single firm production--without suffering from monopoly pricing. Therefore, if full divestiture is finally adopted, there will be need to develop, in parallel, strong regulatory bodies to oversee the production policies and pricing of goods and services. For most of these sectors, the capacity exists at the various Ministries, which with some fine tuning and institutional strengthening could perform these tasks. Plans are already underway for the establishment of a Monopolies and Competition Commission at the Ministry of Commerce, Trade and Industry. Alternatively, the function could be centralized in one institution, a possible candidate being the ZPA, which is developing adequate capacity from the implementation of the privatization program.

### **Issues of Pricing of Assets**

As indicated earlier, one of the contentious issues with regard to the sale of companies was the pricing of assets. A number of critics including the former holding company ZIMCO, opposed most of the negotiated prices for the sale of the companies, insisting that the firms were deliberately undervalued. Other sentiments included statements such as the national assets were being given away. While this kind of reasoning could draw some sympathy, the valuation of assets and pricing of the companies should be seen within the context of the need to put the parastatals in functional form, rapidly. As stipulated in the paper, most of the sales of the major companies were only negotiated and priced after extensive and expensive studies, fortunately financed by donors. The critics of the process did not carry out counter studies to substantiate their claim but were mainly motivated by their affection for the "national assets".

One need not emphasize that a good number of the privatized firms were facing uncertain futures and were themselves heavily indebted. The fair price should certainly take into account these liabilities and the implications for the new owners. Additionally, there are different methods of valuation and depending on the method used, the same entity could have different prices.<sup>20</sup> To complicate matters, most of the parastatals owned substantial non-core and non-productive assets-- including residential real estate and large tracts of land. Some of their equipment and machinery are also technologically obsolete and of little value, yet the Privatization Act requires that they be valued at replacement cost less depreciation. This produces comparatively high prices bearing little, if any, relation to the value of the assets in question.

The point that should be emphasized is that a country will not realize all the benefits of privatization from the sale price. Most of the benefits from privatization will come down the road, from the new investments and turning around of the firms, expansion of output, increased exports, generation of new employment opportunities and incomes, and expansion of the tax base for government revenue. These benefits are even more prevalent when firms of international repute in the sector acquire the properties. The goodwill associated with their operations is usually the trigger for the entry of the local products in international markets. At the risk of getting specific, we will cite an example from the eighties, involving the US multinational Heinz. Heinz's offer to take a stake in a Zambian parastatal in the food processing industry, was rejected on the basis that the offer was low. Heinz quickly moved to a neighboring country where a similar offer was accepted. Heinz not only buys and processes farm produce (and exports) in that country, but the company helps the suppliers with advanced farming practices to get the best yields. These should be the benefits of privatization. Insisting on some fictitious right price will only derail a well intended privatization program, as some of these firms are worth much less than the land on which they stand.

### **Mode of Privatization**

Although this paper does not evaluate in detail the firm level performance of the privatized companies, it is worth making a couple of observations on the outcome of the process in terms of the modes of privatization employed. We indicated earlier the menu of options that the privatization agency has employed to privatize the public corporations, the main ones being: acquisition by use of pre-emptive rights; private sale via negotiated and competitive bids; public offering of shares; dilution of government shares and management and employee buy outs. Experience has shown that the most successful privatisations have been those involving private sales via competitive bidding and acquisition by use of preemptive rights. Companies that have been privatized in this manner have attracted considerable interest from local as well as international investors and have gained substantially from the infusion of new resources in terms of capital and management. As acknowledged by Chilipamushi (1994), private sale through competitive and negotiated bids has been used successfully, especially in cases where the bidding firm buys whole or part of the state enterprise being sold.

On the other hand, companies that were privatized by management buy outs have not performed as well and most of them have not withstood the test of time. Privatization by Management buyout has involved close to 20 firms in Zambia. Firms privatized by management buyouts have not been as successful as their privately sold counterparts for a variety of reasons. Firstly, this procedure rarely involves the inflow of new capital into the operations of the firms. The "buyers" rarely have any funds to inject into the operation or make payments to the government for the assets. They instead negotiate terms with the privatization agency under which nearly the entire payment for the acquisition of the firm is deferred to some future date into the next century.<sup>21</sup> Secondly, the employee/ management buy out does not result in the infusion of a "breath of fresh air" of new management and practices. The management continues to be trapped in the same parastatal culture that the privatization process is intended to steer the firm from. For mainly the two reasons advanced, the management buyout has not been very successful as a privatization tool. The results have been that most of the firms privatized in this manner have collapsed. There are no winners out of such schemes as the government does not get revenue from the "sale", and the collapse of the firm leads to all kinds of income and welfare losses for the workers and the entire economy.

### **Corporate Status of Investors**

Another issue that is worth considering is the status of the investors in their own countries. The position of organizations such as the CDC is of particular interest. CDC is not a private company but a British government owned organization that has a mandate to make investments in many of the United Kingdoms former colonies. Although a parastatal itself, CDC has also worked for the promotion of the private sector. Currently, CDC is behind many venture capital funds in Africa and has worked closely with the IFC in such endeavors. The role of CDC has often posed difficult questions. Can a foreign state-owned enterprise be regarded to be better than a local state enterprise? Can we regard a company sold to a foreign parastatal as privatized? These questions will assume even greater relevance for *francophone* countries given the large number of French parastatals that are likely to bid for companies under privatization in these countries. The position of these parastatals some of which are slated for privatization in their own countries is much more interesting than CDCs, whose role could

be much more justified as its function is mainly one of an investor as opposed to being an operator. With increased acquisitions in Zambia, CDC may increasingly assume a more operational role.

## Conclusions

A considerable number of countries in Africa have embraced privatization and private sector development in general, as means of accelerating investment and growth in their economies. Indeed for many, the issue is no longer whether to privatize but when and how best to do so. In this paper we have examined the objectives and rationale for privatization, citing empirical evidence from the emerging literature on the micro and macroeconomic issues surrounding the concept. In general, superiority of private over public ownership is attested in particular with respect to efficiency considerations and increased productivity from independent management unencumbered by government multiple objectives. Privatization also facilitates government specialization in activities where it has comparative advantage, including human capital enhancing activities, provision of services and creating the legal and institutional framework conducive to increased investment.

As earlier indicated, Zambia was one of the earlier countries to embark on a major privatization exercise as part of its economic reform program started in 1992. This paper has reviewed Zambia's experience with its privatization program, highlighting the major tools and mechanisms employed, and the achievements and constraints faced by the authorities in privatizing one of the largest public sectors in Africa. While acknowledging that it may be too soon to have a complete evaluation of the privatization program in Zambia, we have attempted to evaluate the process in the context of the major activities and milestones achieved over the past five years.

Our analysis reveals that the program has made satisfactory progress with a substantial number of companies privatized by the close of 1996, after an initially slow start and some reluctance to proceed with the privatization of "blue chip" firms which would have put the process on a higher footing. Zambia has also attracted a significant number of foreign investors, including previous owners of some of the firms. The majority of these firms belong to organizations which are at the leading edge of their business, and are in a position to introduce new technologies designed to increase productivity. In addition, their international outlook places them in a good position to develop foreign markets in an increasingly competitive global environment.

Finally, we wish to underscore the fact that Zambia's young but relatively successful privatization program, has been driven by strong political goodwill and support. Unusual political consensus to move ahead with the transition to a market economy has been gradually built among all the interested parties, including political groups, the business community and civil society. This underscores the need to carry all parties with the process and ensuring ownership of the program at all levels.

## Notes

1. The public sector or public enterprises will be used interchangeably to mean public production for private consumption-i.e. output is sold in the market (Galal, et.al.1994).
2. Initial resistance came from the state enterprises themselves and the parent company, ZIMCO.
3. A natural monopoly is defined as an entity whose costs of production are sub-additive. An industry is a natural monopoly if the production of a particular good or service by a single firm minimizes costs. The typical example is production of a single commodity where long run average cost declines for all outputs.
4. Sachs (1993), *Poland's Jump to a Market Economy*, MIT, Cambridge.
5. This is a real problem although most would like to argue that technical assistance could be arranged for these studies. It remains, however, that these can be expensive and drawn out exercises.
6. World Bank estimates.
7. At independence copper exports constituted over 90% of export revenue and the copper industry contributed over 50% of government revenue.
8. See Anne Krueger (1990) for detailed discussion on Government failures of commission.
9. Figures from *IMF Financial Statistics Yearbook*, December, 1995.
10. In 1969, the urban population was 29% of the country's population. This rose to 40% in 1980, and stands at 53 % at present, one of the largest proportions in Africa.
11. In case of residential properties, the law on registration of title to land had to be changed to facilitate private ownership of individual apartments.
12. The deferred payment method has been used extensively mainly in privatization involving management buy outs.
13. The Government encouraged the process by allowing tax free importation of buses and minibuses for a limited period of time.

14. Tate and Lyle paid US 20.8 million for 40 percent and CDC paid USD 16 million for 30 percent. 30 percent of was reserved for sale to the Zambian public. The initial floatation of 7 percent of was done in August, 1996.
15. The proceeds of sale are in most cases substantially reduced/eroded by the transaction costs involved in preparation of the company for sale, e.g. industry sector studies, company valuation costs, and accounting fees, asset valuation fees, legal costs etc.
16. Budget Statement of Minister of Finance, Ronald Penza (1997).
17. Budget statement, 1996.
18. Later repealed and replaced by the Investment Act, 1993.
19. It may be noted that private sector participation has in effect been permitted in telecommunications, with the approval of cellular phone operations which gives the opportunity for new entrants.
20. The methods include net asset valuation, historical profits, projected future earnings, valuation of going concern, break-up asset valuation etc.

This conforms to Jeffrey Sach's observation that sitting managements raise the pressure for the enterprises to be "given to them" or argue for some kind of sub-optimal management buy out.

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## ANNEX 1

## Page 1 of 2: COMPANIES SOLD TO FOREIGN INTERESTS AND AREAS OF ACTIVITY

Name of Company	Type of Business	Name of Buyer	Country of Origin	Amount Paid
<b>Kabwe Industrial Fabrics</b>	Packing Bags	Namibstar Pty	Namibia	\$300,000
<b>Dairy Produce Board-Mazabuka</b>	Milk, Dairy Products	Bonzam Ltd.	South Africa	
<b>Dairy Produce Board-Lusaka</b>	Milk, Dairy Products	Bonzam Ltd.	South Africa	\$800,000
<b>Dairy Produce-Kitwe</b>	Milk, Dairy Products	Bonzam Ltd.	South Africa	
<b>Northern Breweries</b>	Lager Beer	Lonrho	United Kingdom	
<b>Nanga Farms Ltd.</b>	Mixed Farming	C.D.C.	United Kingdom	
<b>Chilanga Cement Limited</b>	Cement	C.D.C.	United Kingdom	\$5.4M
<b>Zambia Breweries Ltd.</b>	Lager Beer	South African Breweries	South Africa	\$7,501,403
<b>Zambia Sugar Company</b>	Sugar	Tate & Lyle	United Kingdom	\$20m
		C.D.C.	United Kingdom	\$16m
<b>National Breweries Ltd.</b>	Opaque Beer	Hendricks Syndicate	United Kingdom	\$1,875,000
<b>Kapiri Glass Products</b>	Glass, Bottles	Floco	Germany	\$1.4m
<b>Zambia Engineering Company Ltd.</b>	Construction	Energoproject	Serbia	K425,798,000
<b>Agip Zambia Ltd.</b>	Retail Oil Distribution	Agip Petrol SPA	Italy	\$850,000
<b>Kafironda Ltd.</b>	Explosives	Covilink	South Africa	-
		Cobar	United Kingdom	-
<b>Zambia Refiners</b>	Oil Blenders	B.P.	United Kingdom	-
<b>Lublend</b>	Oil Blenders	Mobil, Agip, Caltex, Total	Various	-
<b>Pamodzi Hotel</b>	Hotel	Tata/Taj Hotels Group	India	K2,536m
<b>ROP Ltd.</b>	Edible Oils, Soaps	Unilevel Plc	United Kingdom	\$3.5m

<b>Mulungushi Travellers</b>	Passenger Bus Service	Dieter Maurer	South Africa	R420,000
<b>LINTCO-Chipata</b>	Cotton Ginnery	Clark Cotton	South Africa	R3m
<b>LINTCO-Gwembe</b>	Cotton Ginnery	Lonrho	United Kingdom	\$2m
<b>LINTCO-Lusaka</b>	Cotton Ginnery	Lonrho	United Kingdom	\$4m
<b>Mfuwe Lodge</b>	Hotel	-	-	-
<b>Zamhort-Lusaka</b>	Fruit juices, Jam, etc.	Food Corp. Limited	South Africa	-
				\$3,565,000
<b>Zambia Coffee Company</b>	Coffee	African Plantations Corporation	South Africa	\$115,694
<b>MEMACO Farms</b>	Mixed Farming	Simon D. Burges	-	\$232,000
<b>ZAMEFA</b>	Metal Fabricators	Phelps Dodge	USA	\$3.2m
<b>BP Zambia Ltd</b>	Retail Oil Distribution	B.P.	United Kingdom	\$3.2m