POLICY BRIEF March 10, 2005

Ghana's Privatization Programme: Lessons and Way Forward

MAIN ISSUES

The policy brief aims to disseminate information on research findings and their policy implications. In this edition, the paper presents an assessment of Ghana's privatization programme and how it has improved the Global Competitiveness of the Ghanaian economy.

It also reviews Ghana's divestiture implementation programme and its relative progress.

Special Studies Office
Research Department
Bank of Ghana
Box 2674
Accra. Ghana

Tel: +233(0) 21 663082
Fax: +233(0) 21 668932
bogsecretary@bog.gov.gh
www.bog.gov.gh

The Issues in Brief

During the 1950s, an Industrial Development Corporation was established which set up a number of publicly owned commercial enterprises. Though the initial idea was to sell out these commercial enterprises to the private sector, the then government headed by the late Dr. Kwame Nkrumah later changed his mind and instead chose the line of getting the state deeply involved in the running of the established commercial enterprises. The government also held the view that the country would be hampering its advancement to socialism if private capitalism were encouraged.

Beginning 1983 however, Ghana embarked upon major social, political and administrative reforms through the adoption of Economic Recovery and Structural Adjustment Programmes. One of the key planks in these reform platforms was the rolling back of the frontiers of the state through a policy of privatisation. Whilst the concept of privatisation connotes several meanings to several commentators and observers, it basically involves the transfer of ownership of public resources or assets to private individuals and firms through various options. This policy was to set the pace for a comprehensive program of opening up the country to foreign direct investors and create the kind of environment that promotes the growth of the private sector.

At the same time, the program was meant to fulfil a donor-based recommendation for pruning down the overblown public sector and detach government from running inefficient enterprises. The evolving thinking and recognition around the time was that the government was over indulging itself in activities, which on efficiency grounds belonged to the private sector. Specifically, the following reasons were cited as prompting the authorities to adopt the privatisation policy: excessive bureaucracy, overstaffing, a lackadaisical attitude towards state activities, a lack of entrepreneurial drive and acumen which constituted the hallmarks of private business, poor incentives for management and low working capital and investment.

In view of the stated and related shortcomings of state run business institutions, the government set up the Divestiture Implementation Committee (DIC) to plan, monitor, coordinate and evaluate all divestitures. The divesture process was carried out in such a way that once a firm is listed for divestiture, divesture of the asset is undertaken either in whole or in (fragmented) parts. In the case of a joint venture between the government and the private sector, the government shares are sold out to private sector investors.

After over a decade of implementation of the privatization program, about 335 companies have so far been transferred to the private sector(DIC).

As privatization continues, the

incentives, custom import duty exemptions and investment guarantees were made available to potential investors.

Generally, the investment climate has improved. The GIPC has registered over 1,400 projects since1994 with the mining sector experiencing substantial capital injections. General

has changed over time and the current democratic dispensation the country is enjoying has also instilled some confidence in the private sector compared to the era of military rule. Ghana's participation and ratification of various international investment insurance arrangements

and other agreements such as the Multilateral

helped in improving the investment climate.

Investor perception about the general business environment has improved significantly albeit more needs to be done. According to a Bank of Ghana report on private capital flows in Ghana, both foreign and domestic investors on the average hold a positive perception on a wide range of critical issues that are fundamental in informing their decision to invest or maintain their investments in Ghana. These include economic and financial factors; political and good governance; efficiency and cost of infrastructure; labour, environment and health matters; and the overall inward and outward investment policy stance of the government. Generally, a positive perception for the above issues is critical in enhancing the country's global competitiveness position, which is a prerequisite for attracting global private capital flows.

Though some efforts have been and continue to be made in a bid to attract foreign private capital into the Ghanaian economy, a lot still needs to be done if the nation is to improve her standing in the Growth Competitiveness Index (GCI), which is a key determinant of the direction of global capital movement. Of the twenty-five countries in the African GCI ranking, Ghana stood 10th behind countries like Tanzania, Namibia, and Mauritius[1]. This is clearly reflected in the sub-index rankings where the country placed 10th, 11th and 14th in the public institutions, macroeconomic environment and technology index respectively. At the global level, the country registered the 68th position showing an improvement over the 2003 position of 71.

The trend suggest that to become more competitive in attracting global investment, the country need to improve her position in the growth competitiveness index since it is very fundamental in determining the direction of global capital movement. The correlation is to some extent seen in the African rankings as countries such as Botswana, Tunisia and South Africa, which occupy the top three positions, happen to be among the top recipient of Foreign Direct Investment in Africa.

In the case of Ghana, policy makers must continue to explore policies that have the potential of improving the country's position in the GCI rankings. Apart from policies aimed at stabilizing the macroeconomic front, there is the need to improve public sector institutions that will result in efficiency in work delivery and a cut down in the

Mode Of Divestiture and Results

The government agency that was established to undertake the process of divestiture is the divestiture implementation committee. The preliminary stage in the divestiture process is to identify or list various firms to be divested. Gathering information and documentation on each of the listed firms follows this. Once that has been done, a decision is made as to the preferred mode of divestiture. In the past, various modalities have been used by the DIC to conclude divestiture transactions. These include:

- The creation of a joint venture companies between the state and the private investor with the state as minority shareholder while management control remain with the private investor.
- Trade sales to a private sector investor or consortium of the enterprise's assets (either as a whole or in parts if the enterprise comprises a number of distinct businesses or divisions).
- Leasing of plant and equipments, where the investor undertake the necessary investment to upgrade the asset and manage them for an agreed period with an option to acquire them within the lease period.
- Total acquisition of shares by private investors while the government absorbs the existing liabilities of the company.

Following the launch of the privatization program, the attention of the international business community has been drawn to Ghana. This was reflected in major sales such as the Ashanti Goldfields Corporation, Ghana Telecom, Social Security Bank, and the Ghana Ports and Harbours Authority.

As part of efforts aimed at assessing the performance of the divestiture program, the DIC undertook series of studies, the conclusions of which point to the fact that the privatization program has been beneficial not only to the private investors but to the economy as a whole.

Divesture has resulted in considerable increase in the volume of sales of privatized companies as a result of improved productivity arising from the injection of new capital and improved production arising from the injection of new capital and improved management practice, into several of the divested companies. The new investment has increased installed capacity as well as capacity utilisation. To enable the divested companies recommence operation on a clean slate, government has assumed responsibility for the settlement of their pre-divestiture liabilities.

On the whole, an important outcome of the divestiture process is the increase in capacity utilisation, which has resulted in a general improvement in employment. It is estimated that employment has shot up by about 59% in the divested companies.

It is important to state that the widespread funding of state owned enterprise through renewal of their plant and equipment by the government and the guarantee of loans and other facilities by government have ceased in respect of divested companies. Also, there is ample evidence to show that contributions to government finance by post divestiture enterprises, in the form of taxes have improved considerably. In the case of newly created joint venture companies, higher dividends are being paid to the government.

Another important benefit that the divestiture program has brought to the nation is the non-financial benefit to the government through the relief of the burden of administering and supervision of State Owned Enterprises (SOEs), which is no more required in respect of divested companies.

The country is currently benefiting from technology transfer through the divestiture program as many divested companies have made efforts to introduce new equipments to replace old ones. They are taking steps to invest in their workforces by upgrading their skill levels to help build the technological capability required to efficiently and effectively utilise all their production resources and to improve them over time.

On the whole, available statistics shows that divested companies are making substantial headway in performance, contrary to fears of job loss associated with privatization. This is generally manifested in new investment and improved management practices resulting in improvement in productivity.

The Role of legal and Regulatory Framework in The Growth of Private sector Investment

A lack of appropriate legal and regulatory framework in the country could be perceived by potential investors to mean the absence of credible industrial policy framework. The existence of a regulatory framework is necessary in boosting investor confidence with regards to the expected rules of the game in each industry.

Even though some changes have been made in the legislative framework in various sectors of the economy, it does not seem to follow any clear articulated policy framework. To help give credibility to such policy framework statements, related legislation including implementing laws in line with the policy statements are essential, as is subsequent consistent implementation of such legislation.

The way that the legal and judicial systems work is a critical determinant of FDI and most importantly high value FDI destined for export markets which can go anywhere and which need a reliable and hassle free environment. Lengthy and non-transparent procedures combined with unpredictable outcomes, in both the executive branch of the government and in the courts, are among the main problems in this area.

Incomplete reforms and poor implementation of laws and regulations are the overarching issues. If adopted laws are not implemented on time it could contribute to the general perception of an unpredictable legal framework. Some critical issues usually raised by foreign investors are the extent to which they are confident in the impartiality and quality of the commercial courts.

This and other related arguments suggest that the nature of a country's legal, regulatory, and to a large extent institutional framework play a key role in shaping investor confidence and subsequently boosting investment in the economy. Generally, the ineffectiveness of the above issues has played a significant role in creating conflict between the government and private investors.

The impact of state-Investor Conflict on Investment and Private Sector Development

Government-Investor conflicts can have far-reaching implication on the ability of the country to attract enough foreign capital inflows into the economy. Added to this, the persistence of litigation usually serves as a drain on the national budget given the monies spent in negotiations and settlement charges.

Generally, the fact that the country continues to experience series of litigations between the government and foreign enterprises have its root cause in the way and manner investment laws are formulated and the kind of negotiations that go into partnership agreements with foreign companies.

The trickle down effects of litigations go a long way to undermine any genuine effort by the government to pursue a serious private sector development strategy. Essentially, companies involved in such cases are not able to expand since it becomes difficult for them to raise loans from external financial markets, which invariably impact negatively on their growth and profitability. Foreign companies intending to move capital into the economy will be reluctant given the uncertainties in the legal system and the credibility of the government to keep the law as straight forward as possible.

It is significant to outline that if the government is to achieve its private sector development strategy and consequently make the nation a major Foreign Direct Investment (FDI) destination, then the government needs to re-examine its relationship towards private investors in general by for example revamping the legal system and specifically those relating to foreign investors.

Arbitrariness and lack of transparency in public administration have been found to be some of the biggest causes of litigation, which serves as disincentives to foreign investors. For example, the behaviour of immigration officers and judges in the courts is at times so unpredictable and inconsistent that a potential investor will prefer a more conducive legal and judicial system.

Bureaucratic structures, which promotes corruption and anti-private sector sentiments within the civil service to a large extent account for the inappropriate design and formulation of investment laws leading to litigations and court cases. Also, the predictability of government policies and the dependability of existing legal frameworks are crucial in enhancing a country's image in the eyes of foreign investors.

The existence of litigation between the government and private investors can send a negative image to potential investors that the general legal and regulatory framework lacks the ability to ensure stability in the business environment. This observation has been established empirically in several studies on private capital flows into developing countries. Lack of predictability in terms of the government's respect for its own laws and regulations and lack of cohesion towards inter-agency conflicts discourage foreign investors.

Policy Issues

- Policy makers must endeavour to make the laws and contracts governing foreign investment as simple, clear, and straightforward as possible. For example if a performance target is to be set for a company, then the exact target including details on conditions under which management will be deemed to have failed to deliver, the exact penalty for non performance, and the procedure that the government must follow to conclude that the company has failed to deliver must be explicitly agreed upon by both parties.

- Contracts should be negotiated to seek outcomes that protect the interest of the country as best as possible, to limit the scope for suspicion and cause for disputes. Again, due diligence must always be followed in reaching into agreements with foreign investors. An assessment of some of the issues suggests that in a bid to attract foreign capital into a particular venture, the government end up signing agreements that in the long run tends to be highly sub-optimal.

- The improvements on the legislation front, many of which were achieved in the last few years, are necessary but not sufficient in creating an attractive legal framework for foreign investors. Improvements in FDI legislation in the narrow sense fall in this category of necessary but not sufficient enough to ensure a sustainable increases in FDI inflows.

- One of the critical outstanding impediments to investment is that, implementation of the laws in both the executive and judicial branches of the government are fraught with problems for investors. The most important but difficult reforms needed in this arena are basic changes in the legal and judicial systems, and in the way administrative procedures are implemented.

- Two related recommendations that are worth pointing out include refraining from allowing so much time to pass between the adoption of laws and of implementing them. Also there is the need to seek maximum input from private sector participants, both local and foreign, at the legal preparation phase. Best practice would be to draft implementing regulations parallel to the law or at least to have a detailed draft on how the implementation will look like at the time the law is adopted.

- Seeking significant input from business associations before laws and regulations are adopted will result in adequate legislation based also on the concerns of the private sector. This procedure, a common practice in most OECD countries, increases the knowledge base on which legislation is drafted.

- While the government is pursuing programs aimed at building up investor confidence, it is desirable that steps are taken to institute a comprehensive legal and judicial review to identify and address important items in existing private sector-related laws that are in contradiction with each other or that are not sufficiently clearly defined.

- Finally, a specific institution should be entrusted with improved oversight responsibilities to reduce the likelihood occurrences in state-investor conflicts in the future.