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The Challenges of Implementing Privatization Reform Program of State-Owned Enterprises (SOES) in Kenya 1979 to 2002

Peter Kiiru Kariuki
Western Michigan University

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THE CHALLENGES OF IMPLEMENTING PRIVATIZATION
REFORM PROGRAM OF STATE-OWNED
ENTERPRISES (SOEs) IN KENYA
1979 TO 2002

by

Peter Kiiru Kariuki

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Submitted to the
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Department of Public Affairs and Administration
Dr. Robert Peters, Advisor

Western Michigan University
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December 2006
THE CHALLENGES OF IMPLEMENTING PRIVATIZATION REFORM PROGRAM OF STATE-OWNED ENTERPRISES (SOEs) IN KENYA 1979 TO 2002

Peter Kiuru Kariuki, Ph.D.
Western Michigan University, 2006

Before any more sales of public stakes in parastatals are carried out, we need a robust public debate. We also feel that the interests of Kenyans, whose taxes built those parastatals, should be recognized. A new policy, which gives Kenyans the first right to buy parastatals, is needed.


This study reviews the progress and challenges of implementing privatization of state-owned enterprises (SOEs) reform program in Kenya during the period 1979-2002 as part of the Structural Adjustment Program (SAP). The impetus for implementing privatization reform program has two sources: (1) opposition to further growth of the public sector, and (2) the belief that the private sector would be a more efficient producer. I examine the juncture of international, economic, and domestic factors on the state's ability to transfer ownership of public enterprises from the state into private hands. The challenge is to consider different environmental factors that would enhance implementation of privatization programs and to design an appropriate
model of governmental intervention through the analysis of many development theories, strategies and experiences.

This study seeks to develop a ‘practitioner’s privatization model’; a framework or method for government managers to use when deciding which SOE to privatize or retain. The model draws from the two common approaches of implementing privatization reforms; the “gradual approach” and “big-bang approach” within the context of external and internal dimensions.

The Kenyan case demonstrates the difficulties of implementing privatization in a relatively small open economy with significant legacy of state interventionism. My central thesis is that the political, economic and institutional context and their mutual interaction are crucial in explaining the pace or success of implementing a privatization program. The study is timely and informative with its reflection on the accomplishments and challenges of Kenya’s recent economic reform initiatives. The slow implementation and U-turns so familiar and frustrating to outsiders has a political logic. What appears contradictory from the outside actually comprises an internally balanced political strategy for managing a potentially complex transition.

By focusing on the determinant of implementing privatization reform, this dissertation adds to a growing body of literature on the political economy of market reforms that seeks to further elucidate the evolving global convergence around neoliberal economic reforms.
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DEDICATION

I dedicate this dissertation to my late father, Duncan Kariuki Kinyanjui, who taught me the value and joy of hard work. To my late elder brother Sam K. Kariuki; a good example always makes a good sermon. To the fond memories of my late grandson Ronald Kiiuru, we shall meet again. Finally, to the entire Kariuki family for the support and encouragement that has enabled me to endure as a student.
ACKNOWLEDGMENTS

First and foremost, I want to thank very much my committee members: Professor Robert Peters, my committee chair, for his encouragement and his excellent advice and insightful instructions and criticism. I am also thankful to the other committee members, Professor James Visser and Professor Michelle Miller-Adams, their commitment and comments were of immeasurable help and inspiration. I would also like to thank Professor Peter Kobrak (now retired) for the intellectual support extended in the course of my studies. I also want to recognize the support I have received from the Resource Sharing Center-Waldo Library. They did a wonderful job.

Financial support in the form of Graduate Assistant and Graduate Fellowship from the Graduate College and the School of Public Affairs and Administration is gratefully acknowledged.

During the course of my studies, I have enjoyed warm hospitality and great kindness from many friends and I take this opportunity to thank them all. I particularly want to thank my fellow graduate student with special reference to the cohort of 2002. Special thanks to Kenyan community in St. Louis Missouri for their support during the difficult times I have gone though.
Acknowledgments – Continued

I owe much debt to my Mom, my brothers, and sisters for being away from home for so long. Their unfailing love made this dissertation possible. I need to acknowledge the sacrifice of my wife, my two sons and two daughters and last but not least my granddaughter whom I long to see.

Even a favorable turn of events can cause serious adjustment problems. One is reminded of Bernard Shaw: “There are two tragedies in life; one is not to get your heart’s desire; the other is to get it.” In every transition, it’s good to look both ways for the victories of the past give courage for the future.

Peter Kiiru Kariuki
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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>KANU</td>
<td>Kenya African National Union</td>
</tr>
<tr>
<td>GOK/ ROK</td>
<td>Government of Kenya/ Republic of Kenya</td>
</tr>
<tr>
<td>SAP</td>
<td>Structural Adjustment Program</td>
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<td>SOE</td>
<td>State-Owned Enterprise</td>
</tr>
<tr>
<td>KCC</td>
<td>Kenya Cooperative Creameries</td>
</tr>
<tr>
<td>NCPB</td>
<td>National Cereals and Produce Board</td>
</tr>
<tr>
<td>MOF</td>
<td>Ministry of Finance</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
</tr>
<tr>
<td>GDP</td>
<td>Gross Domestic Product</td>
</tr>
<tr>
<td>MPND</td>
<td>Ministry of Planning and National Development</td>
</tr>
<tr>
<td>PRPC</td>
<td>Program Reform and Policy Committee</td>
</tr>
<tr>
<td>SSA</td>
<td>Sub-Saharan Africa</td>
</tr>
<tr>
<td>KP&amp;TC</td>
<td>Kenya Posts and Telecommunication Corporation</td>
</tr>
<tr>
<td>KP&amp;LC</td>
<td>Kenya Power and Lighting Company</td>
</tr>
<tr>
<td>KA</td>
<td>Kenya Airways</td>
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<tr>
<td>KLM</td>
<td>Dutch Airline</td>
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<tr>
<td>EAC</td>
<td>East African Community</td>
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<tr>
<td>WB</td>
<td>World Bank</td>
</tr>
<tr>
<td>ESTU</td>
<td>Executive Secretariat and Technical Unit</td>
</tr>
<tr>
<td>ICDC</td>
<td>Industrial and commercial Development Corporation</td>
</tr>
<tr>
<td>UNECA</td>
<td>United Nations Commission for Africa</td>
</tr>
<tr>
<td>IATA</td>
<td>International Air Transport Association</td>
</tr>
<tr>
<td>EEC</td>
<td>European Economic Community</td>
</tr>
<tr>
<td>MOA</td>
<td>Ministry of Agriculture</td>
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<tr>
<td>SIDA</td>
<td>Swedish International Development Association</td>
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<td>FINIDA</td>
<td>Finish International Development Association</td>
</tr>
<tr>
<td>DANIDA</td>
<td>Danish International Development Association</td>
</tr>
<tr>
<td>KShs.</td>
<td>Kenya Shilling (1US$= KShs. 75.)</td>
</tr>
<tr>
<td>FAO</td>
<td>Food and Agriculture Organization</td>
</tr>
<tr>
<td>EC</td>
<td>European Commission</td>
</tr>
<tr>
<td>ODA</td>
<td>Overseas Development Assistance</td>
</tr>
<tr>
<td>WPGE</td>
<td>Working Party on Government Expenditure</td>
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<td>PERP</td>
<td>Public Enterprise Reform Program</td>
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CHAPTER I

PROBLEM IDENTIFICATION AND RESEARCH OBJECTIVES

1.1 Overview

From 1963, when Kenya achieved political independence, up to 1979, when a comprehensive review of the State Corporation sub-sector was carried out, the Government's participation in commercial activities grew rapidly and broadly resulting in state dominance in various forms (including monopolies) in many commercial activities. The establishment of the state-owned enterprises (SOEs) also called "parastatals," was driven by a national desire to: (a) accelerate economic social development, (b) redress regional economic imbalances, (c) increase Kenyan citizens' participation in the economy, (d) promote indigenous entrepreneurship, and (e) promote foreign investment through joint ventures. This desire was expressed in the Sessional Paper No. 10 of 1965 on African Socialism and its application to planning in Kenya (Republic of Kenya, 1965).

Over the last two decades, neo-liberal economic reforms have swept across the developing world, marking a distinct reversal of ideology and policy. The state-led policies have given way to economic liberalization, addressing the difficulties created by state expansion while bringing the promise of smaller, more fiscally disciplined, and more efficient states. This trend has become pervasive as an increasing number of governments have discarded their state-led development policies, increasingly
engaged with the international community, and tried their hand in the global game seeking growth through market reforms.

In 1992 the Kenyan government initiated a comprehensive state corporation reform program whose main objectives were to: (a) shift more of the responsibility for production and delivery of products and services from the public to the private sector, (b) reduce the demand of the state corporations on the Exchequer, (c) rationalize the operations of SOEs and response to market signals, and (d) broaden the base of ownership and enhance capital market development (ROK, 2005).

The program began in July 1992 with the issuance of the Policy Paper on Public Enterprises Reform and Privatization in which the government outlined the scope of the program, the institutional framework and the guidelines and procedures to be applied in privatizing state corporations. The paper pointed out that there were 240 commercial public enterprises with public sector equity participation and classified the SOEs into two categories: 207 were classified as non-strategic; and 33 were classified as strategic. The government defined public enterprise as “strategic” if they provide essential services or are considered to play a key role from the viewpoint of national security, health and protection of environment. By the time the first phase was completed in 2000, the program had raised Kenya Shillings 10.4 billion (US$ 248 million) (ROK 2005). Most of the non-strategic SOEs were fully or partially privatized, liquidated, sold under receivership while the strategic SOEs had been reduced to 14 after a change in strategy in 1998 when the government provided approval for private sector participation in some of the strategic enterprises (ROK,
The implementation of the second phase is planned for the period 2005 through 2007 with the initial action of legitimizing the process through the enactment of a privatization bill, which was approved in 2005.

The implementation of the program has had a number of weaknesses. The study examines the barriers to sustained implementation, the role of donor community and the pitfalls associated with poorly designed or inappropriately sequenced reform programs. The difficulties in building up an effective coalition of interests to support reform are examined, together with issues relating to the management of change and sustaining the reform process. The study reviews the underlying theory and objectives behind the reform of SOEs and presents some evidence of actual cases implemented. The study identifies two common approaches to implementing privatization programs (gradual/government approach and big-bang, or shock/market approach) and discusses the advantages and disadvantages of each option, including the economic and social costs.

The study outlines the progress on the implementation of reforms in the SOE sector in Kenya between 1979 and 2002 and assesses the degree to which the domestic political and external donor influences in particular have affected the commitment to, and sustainability of, Kenya's reform program. The relative importance of these issues varies between developed and less developed countries. Reform in developed countries has been designed to contend with sluggish economic growth and changes in technology but against a background of functioning institutions. In less developed countries, reform strategies have to address the issues
of inequitable distribution of resources, poverty, improving poor service quality and corruption, in the context of very limited institutional capacity.

1.2 Organization of the Study

The following sections of this chapter cover the scope and research objectives, justification and scope of the study, significance of SOE and statement of the problem followed by research questions. The literature review is covered in Chapter Two and includes details of the international, economic, and domestic factors that the subsequent analysis will rely on in its examination of implementation of privatization policy. Chapter Three comprises the conceptual framework and research methodology and includes the proposed practitioner privatization model. Chapter Four covers the Kenyan context. Chapter Five is the application of the practitioner privatization model. Chapter Six includes the conclusions of the study and draws out some policy implications and future research needs in light of the policy analysis.

1.3 Scope and Research Objectives

This study reviews the past, current, and future status of the implementation of privatization policy in Kenya for the period 1979 to 2002. The time period is significant, as it covers a single administration of Kenya’s second president. The year 1979 was the start of when the government took the initiative to review the operations of SOE and also the start of the structural adjustment program in Kenya with the first structural adjustment loans in 1980. The year 2002 marked the end of the first phase
of implementation of the privatization program and also the beginning of a new multiparty government.

Analyses that focus on profits as a measure of efficiency obscure the diversity of purposes that lie behind the establishment of SOEs and are inappropriate in markets that are highly uncompetitive. Equally, the inadequate attention given to non-economic factors and the use of SOEs as political patronage has conferred limited success to implementation of privatization policy in achieving the goal of enhancing efficiency, private sector investment and employment. As Reich (1995) has argued, policy reform is a profoundly political process, affecting the origins, formulation and implementation of policy. Policy-makers, whether politicians or bureaucrats, are acutely aware that reforms are often unpopular and can cause significant social instability.

Evidence so far is that implementation of privatization reform programs has not produced the expected results and there is considerable debate in both academic and official circles on why privatization has not fulfilled its promise. The problem seems to be not privatization per se, but the ideological and policy context within which this process is occurring. Implementation of privatization of SOEs is taking place as part of the stabilization and structural adjustment programs that constitute the dominant policy initiatives of the Bretton Woods institutions in Africa. It is also occurring within a political context in which there are increased demands for transparency and accountability in the management of national affairs.
This research uses Kenya's efforts to reform SOEs as a case study to understand, in light of the power-bases of African governments, which types of SOE reform are relatively easy and which changes are difficult, or even impossible, given the political realities of the continent. Several questions are raised in an attempt to understand the implementation process in Kenya between 1979 and 2002. For example, what motivated the mounting of the SOE reform process? How has the government implemented these reforms and to what extent have the reforms actually been carried out? What strategies have been used effectively to facilitate and inform decisions about the design of policy reform? How has the government managed the supporters and opponents of SOE reform policies? The study argues that there is no simple uniform model for SOE reforms. Each country has to devise its own strategy. The choice of reform options can be influenced by technical advice and analysis, but the decision to proceed, and the subsequent success of implementation, will be dependent on political support.

The study proposes an analytical framework to help practitioners in identifying the factors facilitating or constraining their efforts, and conditions that could provide a stronger basis for such efforts in the future. Selected cases are reviewed and illustrated to demonstrate how an understanding of these issues is a prerequisite for designing appropriate implementation strategies. The examples include a consideration of the role and influence of donor agencies. International influences have become increasingly important to domestic policy making. The need for international capital has made policymakers cautious, both in action and in
rhetoric, as fears of loss of investor confidence and capital flight affect both strategy and policy. Research on privatization has highlighted the role of the World Bank/IMF, suggesting that developing states with a higher dependence on international agencies such as the World Bank/IMF are more likely to privatize (White and Bhatia 1998, Ramamurti 1996).

Nellis (1991) points out that the overriding purpose of implementing privatization reform programs is to increase economic efficiency of the enterprises and the economy as a whole. But in addition to economic rationales, political objectives abound as well; among them, the need to reduce state debt and deficits, particularly in cases in which the debt burden has overwhelmed the capacity of the state to keep up with its obligations.

The study is timely and informative and should serve as a guiding tool for government and donors alike in planning future and on-going economic reform and structural adjustment efforts in Kenya. Some of the broad objectives that will guide the study include the following:

- Identify the international, economic, and political factors driving the implementation of privatization policy in Kenya as one of the important policy instruments of the structural adjustment program (SAP).
- Develop an analytical decision-making model to help public managers in their decision process.
- Present and review illustrative cases of SOEs.
- Analyze the political and institutional factors that shape the manner in which SOE reform has been managed and implemented.

- Assess the points of strength and weakness exhibited by the Kenya state in the course of this process.

A number of key features of the Kenyan economy are analyzed that confirm how the policy reform impacts the macroeconomic performance of the economy. Five cases are drawn from various sectors of the economy: two from agriculture, one from communication, and two from transportation. The agriculture sector is an important source of demand throughout the economy and, up to a certain level, the sector’s good performance stimulates the economy.

For each case, the study will examine the case against the practitioner privatization model with particular reference to:

- Historical Background
- External/macro dimension
- Internal/micro dimension
- Policy Alternatives
- PPM Recommendations versus Government Decision
- Implication

The sources of the information used in the study include government policy framework papers, policy statements, and World Bank/IMF papers as well as the author’s own research and work experience in the government within the timeframe of this study. Other sources are published materials in journals, magazines and
newspapers. One important question addressed is: how far has Kenya come in reforming its SOEs?

1.4 Justification of the Study

Kenya is a developing country with a need to maintain a high level of growth to sustain living improvements for its citizens. State-owned enterprise (SOE) reform has been a key element in the Kenyan government's program of development. The aim of this study is to outline the nature of the influences and forces that are shaping the direction and pace of state-owned enterprise (SOE) reform in Kenya.

The IMF and the World Bank began pressing for stabilization and structural adjustment programs in Kenya in the early 1970s. During this period the economy was hit by a series of external shocks: the oil crisis in 1973 and the accelerated deterioration in international terms of trade. In 1986, an IMF-supported structural adjustment program (SAP) was introduced (World Bank 1981). The standard structural adjustment program includes the reduction of government expenditure, high interest rates, liberalization of the trade regime, and reduction of domestic consumption. One of the most important purposes of structural adjustments is to make the economy less vulnerable to future shocks.

By June 1997, the Government of Kenya (GOK) had privatized 145 out of 207 non-strategic public enterprises while committing itself to further privatization. The transition from a public to a private sector-led economy has created adjustment problems, especially for the poor who previously had access to government-subsidized basic services. This transition came at a time when global inflation and a
decline in world markets for Kenya's primary products meant that the poor had to bear a significant part of the burden (GOK 1998).

In addition to SAP, the signing of international agreements such as the bilateral trade agreement with the United States (e.g., AGOA) and planned accession to the World Trade Organization (WTO) also imposes direct demands for structural reform. Other sources of outside influence include international and national aid agencies, which are very active in Kenya and press structural reform as a key part of their agendas (Lofchie, 1993). The World Bank and the International Monetary Fund (IMF), as well as many bilateral donors, urge the government to implement pro-market reforms and provide technical and financial assistance to this end. IMF/World Bank loans have included conditions that seek to tie the government to a set of reform milestones in such areas as trade liberalization, banking, and SOE reform. Increasing integration in the global market is, in turn, a source of growing pressures for further structural reform (World Bank, 1989).

Regardless of the reform pressure many observers, particularly advocates of privatization, note the slow implementation and apparent incoherence of restructuring policies in Kenya since 1986, and point to "reform failure". The study aims at helping to better understand the process of implementing the reforms and to generate information which may support policy makers and planners both in Kenya and around the developing world. Privatization, an integral element of the SAP reform package, represents the most decisive shift in state involvement in the economy away from direct government ownership in the productive sector. Given this, the implementation
of privatization policy is an important subject of study, providing insight into the changing role of the state in the economy and the ramification of such change for growth, development, and state responsibility to domestic groups. There is therefore a need to analyze carefully the political, economic and institutional context in order to assess both the need and potential for reform.

1.5 Significance of SOEs

SOEs have been a major factor in the economy of Kenya, and their economic significance cannot be overlooked. There were 176 SOEs in Kenya in 1982 and at the onset of privatization program in 1992 there were 240. Investment by SOEs accounted for a very sizeable proportion of the total capital formation in the country. In 1978-79 it accounted for 17.3% of the gross fixed capital formation (Grosh and Mukandala, 1994). Agricultural marketing boards handled a substantial part of domestic production and the income of most families in Kenya’s rural areas depends largely on parastatals and their ability to expedite payments to growers and to reduce marketing overheads. Further, parastatals handle about half of the country’s visible exports and they also require large amounts of foreign exchange for the importation of equipment and machinery. The cost of living in both rural and urban areas is significantly influenced by policies pursued by parastatals and their affiliated companies and the resultant effects on agricultural and industrial prices. Thus, they are directly and indirectly responsible for implementing a wide range of government policies. In many ways SOEs are a vital link between wananchi (the citizens) and the government.
1.6 Statement of the Problem

State-owned enterprises (SOEs) have become important actors in many developing countries. They have dominated key sectors and internal and external trade, they have been major borrowers in domestic and world credit markets (Berg and Shirley, 1987), and have commanded a sizeable share of the budget. Consequently, more attention has been focused on their performance.

In many developing countries this performance has not met expectations. Investments that were expected to spur growth and provide taxes and profits to the government became a drag on the economy and a drain to the treasury. Out of their poor performance, a rising interest developed in the divestiture as well as in their rehabilitation and reform.

Until the early 1990s, the Kenyan government had encouraged the growth and proliferation of state-owned enterprises. The government viewed SOEs as a powerful vehicle for economic development and economic independence. This positive view of direct government participation in commercial activities was shared by many other developing and developed countries as well; however, in Kenya and elsewhere, SOEs have proved to be an inefficient vehicle for promoting economic development. Bearing in mind the important role of parastatals in Kenya's society and economy, it is unfortunate that many of them have had serious shortcomings. The shortcomings have constituted a serious threat to economic growth and hence the need exists to take steps to remedy the problems.
Many of the SOEs brought a host of unintended results that threatened the economic foundation of the industrialization policy they were meant to support. Foremost among these undesired outcomes were the enterprises’ persistent financial losses, their inability to service their heavy and growing debt, the underutilization of their industrial capacity, and an unsatisfactory and deteriorating level of labor productivity. The underlying premise is that these generally disappointing outcomes can be explained, to a large extent, by the government’s failure to link the macro dimension of SOE reforms to their micro implementation level, and to develop administrative mechanisms apt to make state-owned enterprises properly responsive as policy instruments.

As a result of poor performances of public enterprises and pressures from external environment, the Kenyan government launched the privatization policy in 1992 as part of the economic reform package. It was believed that government performance would be enhanced through privatization whereby the private investors take responsibilities in providing multifarious services and products that in turn relieve the government of the budgetary strains and administrative burdens. Given that policy change entails differential impacts on the various interest groups that hitherto have been shaping policy, the concern such as absorption of the losses by those groups who benefit from the current policy must be fully addressed for successful implementation (GOK 2005).

Policy reform geared towards restoring macroeconomic stability and creating an efficient, effective economic environment is one of the urgent challenges facing
Kenya. Two primary aims of the structural adjustment program are (1) to transform economic policies and (2) to correct imbalances in the economy. The program has led to significant progress in some sectors (e.g., trade liberalization); however, initial public enterprise reforms remain marginal. There have been few efforts to identify the factors affecting the implementation of SOE reform in Kenya and this study intends to fill this gap given the inevitability of SOE reform as a major policy tool of economic reform program in Kenya.

This dissertation will discuss the factors focusing on the research questions outlined below.

1.7 Research Questions

The transfer of state-owned enterprises, activities, or productive assets of the government to total, majority, or minority private ownership (privatization) constitutes one of the most popular policy options to improve their performance. However, the approach of the Kenyan government towards the adoption and implementation of the reform policy has been half-hearted, fragmented, and contradictory. This begs the question as to how the country’s SOE reform goals might best be achieved given the fiscal, political, social, and economic context within which it has been operating.

In line with the objectives of the study, this dissertation will address factors influencing implementation and focusing on the following research questions:
1. How have the interests of various stakeholders in the SOE sector (public, private, cooperatives, and donors) compromised or facilitated not only SOE reform policy interventions, but the policy process itself?

2. Why has the pace of implementing privatization in Kenya been rather slow despite having proposed a fairly ambitious divestiture program?

3. How do domestic political characteristics interact to influence reform realization?

4. Which specific factors have had the largest effect on the implementation of privatization reform program?

5. To what extent have SOE reforms been carried out and how can the process be enhanced?

This analysis seeks to answer these questions by examining the process of implementation of privatization. By focusing on one element of neo-liberal economic reforms, this work seeks to inform two issues in the dialogue on implementing privatization in developing countries: (1) are international and economic theories of economic reforms supported (such as ownership and efficiency); and (2) how do domestic political characteristics interact to influence reform realization.

The next chapter examines the theoretical issues central to the privatization and implementation debate on public sector enterprises in order to lay a foundation for subsequent chapters.
CHAPTER II

LITERATURE REVIEW

"We trained hard, but it seemed that every time we were beginning to form into teams, we would be reorganized. I was to learn later in life that we tend to meet any new situation by reorganizing, and a wonderful method it can be for creating the illusion of progress while producing confusion, inefficiency, and demoralization."

Gaius Petronius, AD 66

2.1 Introduction

This section of the study examines the theoretical issues central to the implementation of the privatization reform program, which is one element of the overall structural adjustment program. Structural Adjustment Programs (SAPs) have been a subject of considerable debate among scholars of Africa's political economy, especially since the 1980s. Politicians and policy makers both in Africa and outside the continent, including international donor institutions, have also engaged in this debate. The issues and concerns in this debate have been characterized more by diverse opinions and controversies than by consensus. They include the relevance of SAPs as solutions to Africa's social and economic crisis, the conduciveness of political realities in Africa for the implementation of these programs, and the impact of these programs on various groups in society.

These three broad areas are also reflected in the available literature on these programs: (1) those dealing with the relevance of the programs to the crisis facing the continent, (2) those addressing the political dimensions of their implementation, and
(3) those examining the socioeconomic and political impact of these programs. In the next several pages of this chapter, I shall review and highlight some of the major arguments in this literature.

The first category of the literature on SAPs identified above falls roughly under the first phase of the programs; that is, the pre-implementation stage. The rest of the literature falls under the second phase of the programs, or the implementation stage. This study focuses mainly on issues dealing with the second phase of SAPs and in particular the privatization element. Before turning to implementation literature, a brief review of the literature on privatization is presented.

2.2 Privatization of Public Sector Enterprises

The term 'privatization' (Cook et al. 1988) is used to describe a range of different policy initiatives designed to alter the balance between the public and private sectors. Cook and Kirkpatrick (p. 3-4) distinguish three main approaches to privatization:

1. The first and most common refer to a change in the ownership of an enterprise through denationalization or divesture.

2. The second involves the liberalization, or deregulation of entry into activities previously restricted to public sector enterprises. Removal of restriction on market entry is intended to increase the role of competition.

3. Privatization has been used where the provision of a good or service is transferred from public to private sector, while government retains ultimate
responsibility for supplying the service-franchising or contracting-out or leasing.

Three main issues have been at the center of the privatization program: (1) the relation between privatization and economic efficiency, (2) the effect of privatization on income and wealth distribution and link between privatization and the economic role of the state. Theoretical work that examines privatization offers many reasons why, even in the case of market failure, state ownership has important weaknesses. As Shleifer (1998) states, "...a good government that wants to further 'social goals' would rarely own producers to meet its objectives." Many of the theoretical arguments for privatization are based on the premise that the harmful effects of state intervention have greater impact under state ownership than under state regulation, not that the harmful effects can be eliminated through privatization. The assumption is that the private sector will perform those functions more efficiently and economically (Moe 1987).

The 1970s saw a resurgence of the notion that transferring assets from the public sector to private enterprise would raise both allocative and technical efficiency, leading to greater economic well-being. The intellectual argument in support of this idea linked performance to ownership:

Privatization involves more than the simple transfer of ownership. It involves the transfer and redefinition of a complex bundle of property rights, which creates a whole new penalty-reward system, which will alter the incentives in the firm and ultimately its performance (Veljanovski 1987: 77-78).
Governments have long used SOEs as instruments to achieve their social and economic developmental goals. Until about the 1970s, in most countries it appeared as though they were having some success (Kaur 2004). In the 1980s, however, there were increasing signs of weaknesses in the SOE sector. Protection from competition, bankruptcy and takeover allowed them to become inefficient. The obvious solution was privatization, which was adapted or imposed largely under programs known as stabilization and structural adjustments advocated by donor agencies such as the World Bank and International Monetary Fund.

Wamsley and Zald (1973) defined public organizations as those owned and funded by government and private organizations as those owned and funded through sales or private donations. They assumed that the degree of external control by major institutions of the political economy, such as political authorities and economic markets, is a significant distinction for organizations. Ownership and sources of funding are organizational properties reflecting these sources of control. Publicly owned and funded organizations are hypothesized to be more heavily subject to institutional control processes of government, whereas privately owned and funded organizations are asserted to be more heavily influenced by their economic markets. These distinctions are related to important organizational properties such as goals, decision processes, and structure.

The pursuit of privatization has generally been interpreted as entailing the abandonment of existing development objectives by both proponents and opponents alike. In post-colonial Africa, state enterprise was one of the main instruments
through which development policy was implemented (Tangri 1999). They provided governments with a very direct means through which they could intervene, and were often chosen to fulfill a range of duties such as establishing new industries, providing employment, and controlling the prices of basic consumer goods. Privatization was advocated as a means to free these enterprises from state control, allowing them to drop their costly non-commercial objectives and to respond instead to market signals (Boycko et al. 1996). Opponents of privatization shared many of these expectations, and feared that the sale of state enterprises would entail redundancies, rising prices and the loss of national control of the economy (Pitcher 1996; Harsch 2000).

An alternative to privatization is presented by Manzetti (1993), who argued that the adoption of privatization could represent a change in the means rather than the ends of development policy. If state enterprises had been established to promote certain objectives, but consistently failed to achieve them, privatization should not be interpreted as abandonment of these goals, but of a discredited means to achieve them. Manzetti's analysis raises a number of interesting research questions. Are the objectives of privatization those which were previously pursued through state enterprises, or has there been a narrowing or reconfiguration of these, and what scope is there for privatization to deliver these objectives?

In the literature on privatization, both microeconomic and macroeconomic variables are used to explain differences in the size of the state sector. Some economists focus on inefficiency, arguing that microeconomic factors help explain the sale of state assets (Vernon 1988), and points out that SOEs have contributed heavily
to the cash deficits of developing countries (p. 4). Facing poor economic performance, policymakers are compelled to liquidate some of the state assets (Van de Walle 1989) as inefficient SOEs have contributed to the increasing debts, inhibiting developing countries from achieving sustained economic growth (Bienen and Waterbury 1989).

Others claim that macroeconomic factors including total external debt, current account balances, inflation, and gross domestic product per capita, affect privatization. Whether the result of strong pressures from the IMF or World Bank (Kelly 1996) or domestic political forces (Haggard and Kaufman 1995), countries use privatization to repay loans, reduce government debt, and limit current account balance deficits (Ramamurti 1992; Ridley 1994). In addition, policymakers may initiate privatization reforms as a signal to international lending agencies and foreign investors that the country is serious about stabilization reform in order to attract capital (Ramamurti 1996). Alternatively, policymakers sell unprofitable enterprises to reduce public spending, an important cause of inflation. A country’s per capita gross domestic product (GDP) may also explain the rate of privatization. Higher income countries usually have more potential domestic investors to purchase state assets, limiting opposition from those who fear foreign ownership.

The current political economy offers several political explanations. Many scholars focus on the importance of state autonomy and insulation for providing the capacity to initiate privatization reforms. Because privatization not only draws protests from state workers and nationalists (Bienen and Waterbury 1989) but also
limits political patronage opportunities for politicians, political leaders and their policymakers require some form of insulation. Haggard and Kaufman (1995) contend that the successful initiation of liberalization reforms depends on a centralized executive authority that uses constitutional provisions and emergency powers to bypass pluralist pressures usually hurt by extensive reforms.

Similarly, Mainwaring and Shugart (1997) argue that a “strong” executive facilitates the initiation of market reforms. They also emphasize the need for the president and majority of the legislature to come from the same party to remove obstacles to initiating and consolidating reforms. Ultimately, they support Haggard and Kaufman’s claim that political parties affect whether market reforms are implemented (Bienen and Waterbury 1989).

Williamson and Haggard (1994) argue that a honeymoon period provides newly elected officials with a certain degree of insulation from popular pressures. Political leaders have more ‘freedom of political maneuver’ immediately after taking office, blaming the outgoing government for its problems in addition to having a longer time horizon.

Unlike political capacity arguments, the political will of incoming government may also explain differences in privatization. Based on their ideological predisposition, left-leaning executives are expected to oppose privatization because of job losses to state workers that result from the private sector’s focus on efficiency and economic profits. Drawing on the work of Manzetti (1999), the ideological willingness of political leaders is crucial for the implementation of reforms. Manzetti
also maintains that there are possible interactions between political capacity that promotes state autonomy and the ideological willingness of political leaders to favor privatization. For example, certain institutions may provide important advantages for enacting liberal reforms but only when politicians with a predisposition towards reform are actually in office. Work on vote switching complements these ideological discussions. As Stokes (1999) argues, politicians will engage in vote switching, adopting policies that appear to go against the perceived ideological predilection of politicians and voters, because the long-term effects of these policies serve the interest of citizens.

2.3 Implementation

Implementing privatization reform programs has proven to be the greatest challenge of the reform process in Sub-Saharan Africa. When compared to similar companies in the developed countries, most African enterprises are overstaffed, highly inefficient, and generally unprofitable. Because these factors necessitate a dramatic restructuring of the enterprise, privatization leads to very high social costs, regardless of the method of privatization employed. It is the social costs of privatization, specifically the painfully high levels of both unemployment and bankruptcy that are at the center of the debate over what pace the process of privatization should take.

In essence, there are two schools of thought on the issue of privatization and the appropriate pace of its implementation. The first approach is Government/Gradual approach and the second one is Market/Shock Therapy approach.
2.3.1 The Debate over the Pace of Implementing Privatization Programs – Gradual versus Big Bang Approach

The central debate about implementing privatization program concerns the feasible pace of an effective implementation strategy. The choice is essentially between a "big-bang," or "shock therapy" approach, in which all reforms are implemented more or less simultaneously, and a more cautious "gradualist" strategy, or what is referred to as incremental approach. If productive resources could move instantaneously and without cost among alternative uses, and if product and factor prices adjust immediately to clear all markets, there would be no interesting issues concerning the speed and order of liberalization. In practice, however, productive resources cannot move instantaneously and costless among different sectors of the economy, and the various markets concerned often adjust with different speeds toward their long-run equilibrium in response to various structural reforms.

In practice, the pace of reform is also heavily influenced by political constraints. This is because all structural reforms involve some distributional changes in favor of some groups and against others, and there are limits on the extent of distributional change that can be tolerated. This type of consideration led some of the earliest writers to address this issue, among them Little et al. (1970), to recommend a gradualist approach to structural reforms. This is in order to minimize adjustment costs and limit the distributional burdens on particular groups in the initial years, and also to ensure that reforms are allowed to proceed at a politically acceptable pace.

More recently, however, there has been greater support for a more rapid implementation of reforms on the grounds that it does not allow time for opposition to
build up and for interest groups to get together and increase their lobbying activities against reforms (Funke, 1993). Bruno (1992) has also argued for the rapid pace of implementation to counter “reform fatigue,” which can otherwise build up. Other proponents of a big-bang strategy emphasize complementarities among different parts of a market economy and believe that these parts have to be in place at the same time for any one part to work. For example, they argue private industrial firms will be seriously undermined if there are no private distribution systems and the state distribution system cannot do the job. They thus favor a rapid, all-out transition to market economy (Lipton and Sachs, 1990).

Proponents of a gradual strategy, on the other hand, stress that certain conditions have to be met first before major market reforms could be carried out. For example, McKinnon (1991) advocates that because most reforming governments have large fiscal deficits, government budget has to be brought under control before a price liberalization can be undertaken.

In practice, the optimal pace of reform will depend critically on the initial economic and political conditions facing the reforming economy, and is likely to be dictated by the amount of funds – including foreign funds – that is available to the governing authorities to help finance the reform process.

The optimal pace of reform is also linked in an important way to the credibility of reform. Structural reforms can only succeed if economic agents, and in particular investors, believe that the reforms are lasting and will not be reversed. As Ahluwalia (1996) notes, under certain circumstances a faster pace of reform may add
to credibility if the results achieved in the short term are sufficiently favorable to vindicate the reforms and ensure against reversibility. On the other hand, a more gradualist approach can generate greater credibility if it avoids unnecessary disruption in the short run and allows time for beneficiaries of reforms to emerge with clear vested interests in their continuation.

Perotti's work (1995) is of interest for explaining the predominance of gradual, staggered privatization in developing countries as opposed to the predominance of full, one-shot privatization in developed countries. Abstracting from the hypothesis that these staggered sales reflect a limited capital market capacity, Perotti derives a model that establishes that privatization sales should be gradual to maximize investors' confidence over government policy risk. More specifically, he shows that partial privatizations constitute a reputation-building strategy by the selling government in which willingness to retain a minority stake and to bear residual risk signals commitment to the privatization policy.

The process of implementing privatization programs requires special provisions as well as skills and experience that are not usually found in the public sector. The purpose of privatization is to increase private sector participation in the economy, and the manner of carrying it out is a public process requiring private sector skills. In practice, it is safe to conclude that the two approaches should be regarded as complementary. Sound economic and enterprise operational data are needed to guide privatization decisions, but their existence alone cannot be assumed to move government or other significant actors to action.
International finance institutions like the IMF and WB exert influence on the policy making of national governments in their role as information provider, intellectual leader and policy consultant. Closely connected with their financial influence are the import of liberal ideology and the promotion of specific economic policy objectives and programs. This also includes the privatization of SOEs and the protection of private property rights.

The table below gives a summary of the debate on the Big Bang versus Gradual Approach. As the review above shows, no consensus has emerged whether the Big Bang Approach to reform is superior or inferior to a gradual approach. Further, the order in which reforms should be undertaken has remained a matter of debate.

Table 1: Summary of Gradual Approach versus Big Bang Approach

<table>
<thead>
<tr>
<th>Gradual Approach</th>
<th>Advantages</th>
<th>Disadvantages</th>
<th>Proponents</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>1. Lower social cost for society as a whole.</td>
<td>1. Time factor</td>
<td>Pressman, J. and Aaron Wildavsky (1973)</td>
</tr>
<tr>
<td></td>
<td>2. Decision can be reversed</td>
<td>2. Delayed benefits</td>
<td>Lindblom (1959)</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Big Bang Approach</td>
<td>1. No need for restructuring</td>
<td>1. Massive unemployment</td>
<td>Lipton and Sachs (1990)</td>
</tr>
<tr>
<td></td>
<td>6. Increase credibility</td>
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2.4 World Bank Literature and the Concept of Structural Adjustment Programs (SAPs)

The initial literature on SAPs in Africa emerged in the 1980s and is identified mostly with the World Bank. This literature focuses almost exclusively on the economic dimensions of the programs and represents the Bank’s reaction and response to Africa’s social and economic crisis (World Bank, 1981, 1983, 1984, 1986). This literature deals mainly with the causes and proposed solutions for the crisis, including the economic rationale of SAPs.

The concept of ‘structural adjustment’ comprises a set of economic reform policies that includes the reduction of government expenditure and the reduction or elimination of the balance of the payment deficit, the resumption of higher rates of economic growth, and the achievement of structural changes that would prevent future payment and stabilization problems. The promise of donor support for these economic reform programs was introduced in 1979 when the Governors of the World Bank from Africa requested the Bank to conduct a study to identify the causes of problems that African countries were facing and to design solutions. The findings of this study (World Bank, 1981) attributed the problems to the ambitious but unsustainable domestic development policies pursued by African governments since independence. These conclusions found support in the work of scholars such as Bates (1981) and Hyden (1983). The World Bank saw the problem as arising from the excessive role of the state in the economy and the underutilization of the private sector. Consequently, the Bank proposed that African countries adopt a series of
measures aimed at addressing what this institution believed to be the root cause of the
crisis. It is these measures which constitute Structural Adjustment Programs (SAPs).

Structural Adjustment Programs have been a subject of considerable interest
and debate among scholars of Africa’s political economy, especially since the 1980s.
Politicians and policy makers both in Africa and outside the continent, including
international donor institutions, have also engaged in this debate. The issues and
concerns in this debate have been characterized more by diverse opinions and
controversies than consensus. They include the relevance of SAPs as solutions to
Africa’s social and economic crisis, the conduciveness of political realities in Africa
for implementation of these programs, and the impact of these programs on various
groups in society (Shirley, 2000; Ramamurti 1999, Ralph 1991).

The record of implementation of these programs has been less than impressive
both in Kenya and other Sub-Saharan Africa (SSA) countries. To explain this record,
the World Bank and the IMF initially blamed the lack of sufficient ‘political will’ on
the part of the state (World Bank 1984:8; Haggard, 1985:508). Just what this political
will entailed was never clearly defined, but it appeared to refer to political and other
domestic factors which the Bank and the Fund did not, in the early 1980s, consider to
be within their jurisdiction to criticize or even analyze publicly. As the decade
progressed, and as it became clear that politics was a key determinant of the timing
and the degree to which the reforms were actually implemented, the World Bank in
particular began to focus on what it termed ‘governance’, or political management, in
addition to stepping up its emphasis on the need for improved institutional capacity in SSA (World Bank, 1989).

While a number of scholars (Bates, 1981; Hyden, 1983; Sandbrook, 1985) agreed with the Bank that the state had been the major obstacle to the development efforts of Africa, and that the private sector is the solution, some contributors to the debate had alternative suggestions. The United Nations Economic Commission for Africa (UNECA), for example, while concurring that increased productivity and better use of resources is necessary, did not agree that restoring economic growth is beyond the capacity of the African state. It consequently recommended a continued role of the state in the economy but added that this should be accompanied by improvements in governance. Improved governance, according to UNECA, can be achieved through greater public participation, decentralization, and economic and institutional reforms (UNECA, 1989).

What is being suggested here is reflected in the literature on Kenya’s political economy which is discussed in Chapter Four. The literature is characterized by conflicting interpretation of what shapes and determines both the political dynamics of the country and the allocation of resources. Therefore, the challenge is to understand these processes and deal with them rather than simply assume that the state is inherently inefficient. It is feasible that what is required in Africa is improvement of rules that govern politics and the quality of political leadership. In other words, an enabling political environment is necessary.
2.5 Political Dimensions of Structural Adjustment Programs

Haggard (1985) notes that programs designed without reference to political realities are likely to fail and even generate undesirable political consequences. Herbst also reminds us that “without an understanding of the economic role of the state it is impossible to set the parameters of its political functioning in the future and in particular how it will relate to important constituencies” (Herbst, 1990, p. 953). Herbst does not agree that the state should be stripped of its economic role.

Callaghy (1990) argues that SAPs are incompatible with the logic of African political economy. He describes this political economy as characterized by clientelistic networks built by leaders through state resources controlled by these leaders. These networks are important for maintaining political control. The second major feature of this political economy is the expansion of state size, especially through parastatals, which provide the leaders with resources they need and use for buying political support. Herbst argues that state-owned enterprises are a particularly good source of patronage for leaders. This is because they can employ large numbers of people and direct important resources to specific regions. They also operate in greater secrecy than government in general, and can be used by these leaders for personal ends.

There are additional reasons that may explain why parastatals reform is likely to be resisted in Africa. These have to do with the fear that their sale may benefit only particular ethnic groups. Africa is an ethnically fragmented society in which those in power tend to favor members of their community. Therefore, the fear is that these
leaders may favor their communities and sell most of the parastatals to them. While liberal economists may argue that it does not matter who controls these corporations so long as they operate efficiently, the truth is that ethnic animosity can create political instability. This may undermine the operations of the corporations even after they have been privatized.

Another political consideration affecting the implementation of privatization program is the fear that state withdrawal from the economy is likely to entrench foreign domination and control of the economy by foreign corporations that will move in as a result of economic liberalization (Muriuki, 2000). This would undermine the little economic independence that these countries may have. This concern is based on the fact that the indigenous private sector is weak and cannot compete effectively with multinational companies. Opponents of the regime in power may use this to undermine the legitimacy of the current government, which could affect its ability to govern.

An additional politically problematic aspect of economic reforms in Africa is the fact that the manufacturing sector, especially of consumer goods, generally is monopolized by few firms (Himbara, 1994). In Kenya, the East African Industries is a good example. With its vast economies of scale in consumer products, it has not been possible to initiate an effective competition especially from the local entrepreneurs. It is such considerations that may make some form of state intervention necessary to counter the imperfection of the market and protect the consumers against exploitation by monopoly firms. Adjustments must take into account the context in which it is
required to operate. The initial literature on political dimensions of adjustment implies that some African regimes are making political adjustments to enable the implementation of SAPs. There is, however, a wide variation in the response mechanisms across Africa. These developments have led to attempts to explain the factors that determine the political capacity of governments to succeed or fail in implementing privatization programs. It is to this literature that I now turn. This literature has emphasized three variables. These are regime type, interest and pressure group politics, and state autonomy and capacity.

2.6 The Regime Type Theory

The regime type theory has perhaps been the most controversial of the theories explaining the behavior of governments in their handling of SAPs. The initial argument in the debate on regime type is that authoritarian regimes are more likely to be strongly committed to adjustment and thus be better at performance than democratic ones. This argument is based on the assumption that democratic regimes depend on popular support and therefore are unlikely to introduce and implement unpopular policies. SAPs would be opposed or resisted by the people or their representatives. Also implied in the debate is democratic regimes are not autonomous while authoritarian ones are, according to this theory.

Skidmore (1979), for example, argued that democratic regimes permit the formation of alliances in which each thinks it can best protect its interest if stabilization is scrapped. In fact, he argued that all cases of successful stabilization have been carried out by authoritarian governments.
Olson (1983) also alluded to a similar explanation when he observed that organizations for collective action have little or no incentive to make any significant sacrifices in the interest of society and will always attempt to seize the largest share of national output for themselves. Applied to structural adjustment policies, then, various groups with interests in market distorting policies (administered pricing, artificially high wages, subsidies, and tax breaks) would usually support such policies even if the policies are detrimental to the economy as a whole. These groups, according to this line of reasoning, would slow economic adjustment by entrenching economic rigidities and resisting the efficient allocation of resources.

This line of thinking is based on a number of assumptions. First, it assumes that coalitions in democratic regimes will oppose any policy that does not benefit their constituencies directly even if this is good for the economy in the long run. It also implies that such coalitions will always be indifferent to what is good for the economy. The argument implies further that such coalitions exist mainly to oppose policy and will not compromise with the government irrespective of whether or not the policy is economically sound.

These assumptions may, however, not always be correct. If they were, then democratic governments would not implement any policies at all. This is simply because not every policy will benefit all groups in any society. Some groups will always benefit from a particular policy while other groups suffer, lose, or compromise their interest from the same policy. Politics is a give and take exercise. It is not always "winner takes all" as the regime type theory implies. This is why democracies
sometimes succeed in implementing policies in which we would expect strong interest group opposition. Therefore, democracy per se does not appear to be the problem standing in the way of successful adjustment programs.

There is at least one other weakness in the assumption about the strength of authoritarian governments. It can be argued that coercion, which is viewed as the strongest weapon on which authoritarian regimes rely and the use for imposing even unpopular policies, can work only for a time and only for certain programs or policies. In other words, even authoritarian governments cannot rely on coercion forever to implement their policies. They will at one time or another find that they have to seek the support of citizens. As Haggard (1985) observes, “Even well institutionalized one-party regimes face political limits when they try to impose adjustments on politically important constituencies” (p 160).

Part of the problem with the regime type theory is that of classification. Not all regimes classified as authoritarian have identical characteristics or strength to enable them to impose policies on their citizens with ease. The same can be said of democratic governments. Both democratic and authoritarian governments can be weak or strong in a subset of their functions (Midgal, 1988). Governments hardly possess and exhibit the same strength in all their functions all the time. Therefore, it does not help to assume that all authoritarian regimes are able to have their way all the time and over all policies as the regime type theory would have us believe. Finally, the regime type theory has the danger that it supports authoritarian rather than democratic regimes.
2.7 The Interest Group Theory

Other scholars have focused on the role of interest groups without necessarily talking about the type of regime. The argument advanced by such studies is that powerful interest groups frustrate any policy that they think will hurt them. Lehman (1990), for example, argues that one of the most serious problems affecting the implementation of SAPs in Kenya is the friction between manufacturers close to the government and international institutions pressing for economic liberalization. The same study observed that another important domestic constraint to the implementation has been the antagonistic relationship between the African and Asian communities in Kenya. The fear among Africans is that liberalization of the local market increases Asian opportunity to advance their interests (Lehman, 1990). Asians have tended to dominate the manufacturing and to some extent the retail sectors of the Kenyan economy. The fear may, therefore, be understandable.

Another study identified agricultural interests in Kenya as responsible for the failure of agricultural reforms (Mosley et al., 1991). According to this study, agricultural interests of the large-scale farmers frustrated the reforms in this sector because the head of state has had a personal stake in agribusiness and the "distortions" objected to by the World Bank, which formed an important part of the mechanism for ensuring political support for the president's party (Toye, 1992).

2.8 State Autonomy and Capacity

An alternative approach emphasizes the autonomy of the government and in particular the technocrats from political influences and considerations in the
implementation of SAPs (Haggard and Kaufman, 1989; Callaghy, 1990). This approach also recognizes the importance of qualified and competent professional economists and administrators. According to this approach, the success of these technocrats is enhanced by the presence of a strong chief executive. Weak executives, it is pointed out, not only fail to protect their professionals but also are particularly likely to procrastinate in implementing programs, while rapid response is associated with strong executives (Nelson, 1990).

Callaghy (1990) has argued that the degree to which an African government can adjust is determined by its ability to insulate itself from the political logic and characteristics that define Africa's political economy. He points out that the ability to insulate is affected by how the economic crisis is perceived by the rulers, the degree to which decision making is influenced by the technocrats as opposed to politicians, the degree of government autonomy from the powerful sociopolitical forces, the capacity of the state apparatus and the overall level of economic development, and finally the nature of dependence on, and extent of external influence and support.

One of the problems with the idea of government or state autonomy is its assumption that a government is monolithic and will always adopt a unified approach to policy. This, however, usually is not the case. Even within the same governmental agency or bureaucracy there are likely to be divergent views on a policy.

It may be necessary to point out here that this diversity of opinion on policy among governmental employees can be found among democracies as well as among authoritarian governments or regimes. Unlike bureaucrats whose job constitutes a
lifetime career, politicians have no guarantee that they will keep their jobs for an extended period. They are therefore unlikely to let bureaucrats have their way on matters of policy if doing so will jeopardize the political survival and fortunes of the politicians.

2.9 Social Dimensions of SAPs

The final category of the literature on SAPs addresses the impact of these programs. Two issues can be identified in this particular area. The first relates to the socioeconomic impact and costs of these programs for specific groups of society. These include women, children, the urban poor and the unemployed (UNCCA 1998; UNICEF 2000). The second relates to the question of whether or not the adjusting countries are doing better in terms of economic growth and employment than those that have failed to sustain the programs.

The implementation of Structural Adjustment Programs in Africa has generated much research and controversy. As expected, research that is sponsored by the World Bank/IMF or produced by their staff gives high accolades to the programs. These researchers almost invariably take the view that there are no viable alternatives to SAPs, and therefore developing countries are better-off with SAPs than without them. Furthermore, they point to growth in gross domestic product, increase in exports, drops in the inflation level, and other macro level changes as evidence of development under SAPs (Zulu and Nsouli 1985; World Bank 1994; Husain 1994).

On the other hand, most of the independent views from academia, charitable NGOs and UN institutions such as UNESCO tend to question the benefits of SAPs.
Concerns about impacts of adjustments on the more vulnerable elements in society: social welfare, spatial inequalities, the environment, labor, gender, and farmers penetrate throughout the literature (Cornia et al. 1988; Stewart 1995). The issues call for detailed study, which is outside the scope of this work.
CHAPTER III

CONCEPTUAL FRAMEWORK AND RESEARCH METHODOLOGY

"'SOE reform' is shorthand for describing a complex, multi-arena process of strategic actions by state business interests, state bureaucrats, party leaders and other state actors who are engaged in the process of managing and restructuring state commercial activities. The diversity of interests and goals involved in this process defy encapsulation under one overarching "reform" umbrella."

(Martin Painter, Contemporary Southeast Asia. Singapore, 2003)

3.1 The Conceptual Framework

The conceptual framework proposed in this study is intended to provide a guide to the public manager toward the variables that ought to be included in the decision of whether to privatize a state-owned enterprise. The approach emphasizes the competing influence of international, economic, and domestic factors. In doing so, it provides opportunities to examine the interaction of these variables and their influence on policy outcomes. A situational analysis should expose the strengths, weaknesses, opportunities, and threats related to the conditions, and identify any changes necessary in eliminating obstacles to the implementation process.

For market reforms including privatization, policy change is the product of a reform alliance between the state, domestic groups, and the international community. The makeup of the alliance is continuously in flux, as reformers within the alliance members vie for policymaking influence (Galal, 1990). In order to implement market
reforms, there must be an active percentage of reformers within the alliance partners; a percentage that changes over time in response to domestic and international factors. The international community in the 1980s and 1990s was a relatively cohesive alliance partner, promoting evolving international norms including financial liberalization, trade liberalization, and privatization (World Bank, 1995).

In contrast, domestic actors represent a more heterogeneous alliance member, and the costs and benefits of market reforms are not distributed evenly among them. Given this, market reform requires a growing percentage of reformers within strategic policymaking positions, supporting or promoting market reforms, often in conjunction with members of the international community.

In order to deter complaints of those opposed to the implementation of privatization program, procedures are needed that would make the privatization program immune to accusations concerning transparency or fairness. As White (1990) points out, policy change provokes intense debate, strains or breaks organizational capacity, threatens those in power, and exacts high political costs. Implementing privatization policy makes the assumption that the policy change can be improved by stakeholders’ consensus of agreed method or criteria. To operationalize the decision-making process and to make it objective, the following would form the basis in guiding the public managers in the decision-making process:

1) Is the current SOE formerly a private entity and if it was then why was it nationalized?
2) Is the SOE operating in sectors where private enterprises can operate effectively?

The study recognizes the need for flexibility in the type of sale to allow case by case decisions regarding the optimal manner of privatization. This leads to the conclusion that a strategic framework is useful for analyzing the privatization decision, one in which privatization is part of a broader framework that includes history and other contextual factors in an analysis that relates ends to means in designing a program.

Strategy formulation begins with the identification of objectives and the determination of methods for reaching objectives. These objectives and activities are then scaled to fit within resource constraints. Each element of a strategy (objectives, activities, and resources) is constrained by political, social, economic, and environmental variables. The objectives and activities of public organizations are constrained by the formal authority provided by statute (Cohen and Eimicke 1995, 196).

A strategic framework for addressing privatization is developed in the form of a set of questions that should be asked by the public manager or agency faced with the decision of whether to privatize. While other questions could certainly be asked, the privatization-strategy formulation process would benefit from raising the following issues:

1. What are the goals of the program being implemented?

   a. Are there any political or social/cultural constraints on privatizing the enterprise?
b. What are the international implications of this failure to privatize?
2. What are the tasks that must be performed to achieve the program's goals?
3. What are the potential political, social, and economic impacts of failure?
4. Is there a competitive market for the activity we are considering privatizing?
   a. How deep is the market? Does it operate in this locality?
   b. Would privatizing this function help create such a market?
   c. What might be done to stimulate such a market?
   d. Are there efficiency gains that might be obtained through privatization?

The implementation process will vary depending on the nature of the policy to be carried out. Different types of decisions will display different characteristics, processes, structures, and relationships among factors that influence the execution of public policy.

Policies can be classified according to two distinguishing characteristics: the amount of change involved, and the extent to which there is goal consensus among the participants in the implementation process (Grindle, 1991; White, 1991). The element of change is important in at least two respects. First, implementation will be affected by the extent to which the policy deviates from previous policies. According to Lindblom (1965) and Wildavsky (1974), incremental changes are more likely to engender a positive response than will drastic ones (Gradual versus Big Bang).

Second, the implementation process will be influenced by the amount of organizational change that is required. Kaufman's (1971) analysis suggests that effective implementation is most likely when the implementing agency is not required
to undergo drastic reorganization. The other critical feature of the policy is the degree of conflict or consensus over its goals and objectives.

The combination of these two features produces a typology of public policies as depicted in Figure 1 (Van Meter and Van Horn, 1975: 460).

According to Van Meter and Van Horn (1975), most of the policies are found in the "major change/low consensus" and "minor change/high consensus" categories (quadrants I and IV). Programs that require major change frequently lead to goal conflict on the part of relevant actors, while goal consensus is usually highest where little change is involved. By definition, incremental policies discourage controversy by deviating only marginally from previous accommodations and practices.

From the configuration of Figure 1 above it can be suggested that the probability of effective implementation will depend, in part, on the type of policy being considered, and the specific factors contributing to the realization or non-realization of program objectives that vary from one policy type to another. The
underlying assumption is that implementation will be most successful where only marginal change is required and goal consensus is high. With this assumption in mind, I turn now to the examination of those factors that are involved in the implementation process.

To examine the implementation of privatization, this study draws upon the theoretical perspective as explained above and from conceptual framework proposed by Stallings and Peres (2000); and the selective privatization model developed by Park (1998). Stallings and Peres model of implementation focuses on the interaction of multiple actors within a constrained environment. When governments want to change the way their economies operate, they make policy decisions and transmit them to the relevant actors. To study this process, response, and the resulting outcomes, Figure 2 sketches a simple schematic of this analytical structure. The framework's primary focus is on investigation of the factors that influence the implementation process, which ultimately shape the nature and extent of change achieved by the reform.

Stallings and Peres' framework begins with the external context, which they model as variables related to international finance and the demand for exports of the country under consideration. The past performance of these and other international variables helps to determine the initial domestic conditions (economic, social, and political) in the country. In the present, the external context has a strong impact on government policy, making certain policy choices more likely than others. Beyond its impact in the policy arena, external finance facilitates investment and technical
change processes, while international demand and the vagaries of financial flows have an impact on the dependent variables, especially growth rates. Figure 2 depicts this relationship:

![Conceptual Framework Diagram]

Source: Adapted from Stallings and Peres (2000) with permission.

Figure 2: Conceptual Framework

Initial conditions within the country are mostly determined by domestic developments, although they are also influenced by external factors. Stallings and Peres take these initial conditions as given, but they are crucial in determining both policy choice and response. From the perspective of policy choice, Stalling and Peres are interested in several economic variables, including growth, inflation rates, the structure of output and employment, and links with the world economy. Social characteristics of the population and the ability of government to make and implement policy decisions are also important. At the enterprise level, the accumulated learning and productive capacity are elements that government must take into account (Stallings and Peres, 2000).
Based on the initial conditions in the country and on external influence, government makes decision on reforms (such as import liberalization, domestic financial liberalization, opening of the capital account, privatization, and tax reform), macroeconomic policies (including fiscal, monetary, and exchange rate measures), and social policies (especially with respect to education and health).

The framework incorporates investment and technical change which arises from the interaction of the reforms with macroeconomics policy and the international context. At the aggregate level the uncertainty created by changes in the rules of the game and the volatility of key macroeconomic variables may lead to a delayed response in investment and technological change. The three dependent variables of the conceptual framework are growth, employment, and equity (Stallings and Peres, 2000). The characteristics of the growth process and the decisions on the type of technology to be incorporated will determine employment generation. Employment characteristics, especially the salary differential between skilled and unskilled workers are important in determining the distribution of income, although this may be offset by other economic and social trends. It is the social costs of implementing privatization, specifically the painfully high levels of both unemployment and bankruptcy that are at the center of the debate over what pace the implementation should take (Dewatripont and Gerard, 1992).

3.2 Practitioner Privatization Model

The main characteristic that distinguishes the proposed approach from other studies of economic reforms is the focus on the interaction between macroeconomic
and microeconomic processes. This is the major contribution of this study to the implementation literature and the on-going debate on privatization. Different countries and groups of firms are affected quite differently by government policies, including structural reforms, and by the increasingly globalized world economy. Some have been able to take advantage of the new opportunities created while others have seen their situations become ever more precarious.

Drawing insight from the theoretical perspective and the models described above, this study develops what I refer to as the ‘Practitioner Privatization Model,’ which may be used to evaluate the existing conditions within a country and enterprise, and thereby determine the appropriate privatization decisions that would enhance the implementation process. Utilizing the framework, I focus on the elements under the control of the privatization manager that can help in the designation and selection of enterprises for privatization. The central message of the study is that a ‘good’ reform program may not be able to overcome political resistance if it is implemented by a Big Bang, but it may become politically viable if it is implemented by a Gradualist Approach. The reform is ‘good’ in the sense that it will benefit a majority of the population.

In spite of increased interest in policy implementation, the field is still quite new and underdeveloped in terms of approaches and conceptual framework. As implementation research evolved, two schools of thought developed as to the most effective method for studying and describing implementation: top-down and bottom-up. The top-down models (Van Meter and Van Horn, 1975; Mazmanian and Sabatier,
1981; 1989) see implementation as concerned with the degree to which the actions of implementing officials and target groups coincide with the goals embodied in an authoritative decision. Van Horn and Van Meter (1975) propose a causal model of the variables they believe to be predictive of successful implementation. Characteristics of implementing agencies, predispositions of implementers, and resources, among other things are considered as crucial. The advice they give is: make policy goals clear and consistent; limit the extent of change necessary; and place implementation responsibility in an agency sympathetic with the policy's goals. Van Meter and Van Horn have recommended intergovernmental communication as they recognize that programs requiring major change lead to goal conflict and calls for consensus building (Van Meter and Van Horn, 1975, 447).

Like Van Meter and Van Horn (1975), Stalling and Peres (2000) identify the implementers closest to the action and their immediate environment as crucial. Their framework's primary focus is on investigating factors that influence the implementation process that ultimately shapes the change achieved by the reform. Stalling and Peres model includes the external actors (context) and domestic actors (initial conditions) and the interaction between them.

Thus any major government reform must take into consideration two elements: (1) the characteristics of the key institutions involved; and (2) the environment within which the institution exists.

Each privatization transaction is different and needs to be designed to meet the specific characteristics and objectives of a country, enterprise and time, taking into
account local administrative, political, economic, social and legal conditions of both
the country and enterprise(s) and assets targeted. The focus is on how, in practice, a
government can go about implementing privatization program rather than on whether
to undertake the effort at all.

The background literature reveals two underlying dimensions that significantly
influence the overall condition for privatization of an enterprise and thereby influence
the methods of privatizing a given enterprise. The two dimensions of greatest
significance are the external/macro dimension and internal/micro dimension of the
enterprise under consideration. In conjunction, they have the strongest impact on the
probability of a successful implementation because they are causally related to the
social and economic costs of privatization.

3.2.1 External / Macro Dimension

The most important factor that must be considered for the privatization
decision method is the external relationship of the enterprise with the external
stakeholders and the society. This dimension basically reflects the degree of
significance of an enterprise in the society (Park, 1998). Certain enterprises may
provide a product or service which is of vital importance and is of national concern.
These enterprises possess a high degree of social significance due to the nature of their
business or the product/service provided. In addition, the degree of social significance
of an enterprise is directly related to the size of the enterprise. Some of the large
enterprises employ a large percentage of the population, and their failure would result
in a high number of layoffs (Dewatripont and Gerard, 1992). Therefore, these
enterprises have a high degree of social significance, and their continued existence may be temporarily or sometimes permanently necessary.

External stakeholders are those institutions that have provided funding directly to the enterprise or through the government. In contrast, a very small enterprise employing a relatively insignificant number of people would have a low degree of social significance. For these reasons, it is necessary to first determine the degree of social significance for each enterprise under consideration for privatization. The second, internal/micro dimension consists of the internal strengths and weaknesses of the enterprise under consideration.

3.2.2 Internal / Micro Dimension

This dimension largely depends on the degree of operational efficiency of an enterprise to be privatized and is directly related to its ability to survive under global competition when privatized. In determining the degree of operational efficiency of an enterprise, it is important to question an enterprise’s overall competitiveness in the marketplace and general productivity level. In addition, any resource or special ability that provides an enterprise with a comparative advantage, or the potential for a successful operation, should also be taken into consideration when determining operational efficiency. Operational efficiency or the internal/micro dimension is of great significance when making privatization decisions, because this factor has a strong and immediate effect on the success or failure of an enterprise in a globalized market.

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3.2.3 Diagnosis of Condition

In order to formulate a suitable method to privatize an enterprise, it is essential to make an accurate diagnosis of the condition under which the enterprise is operating. Based on the above analysis, the public manager can employ the proposed practitioner model matrix to diagnose the condition under which each enterprise is considered for privatization. The diagnostic matrix, Figure 3, will provide overall framework to analyze the condition under which each enterprise is considered for privatization. The enterprises that are relatively inefficient but have higher social significance are positioned in the first quadrant. The enterprises that are operationally inefficient but also with relatively less social significance are positioned in the second quadrant. The enterprises that are operationally efficient but socially less significant are positioned in the third quadrant. Finally, the enterprises which are very efficient but also are very significant will be positioned in the fourth quadrant.

This diagnostic matrix will enable policymakers and administrators to understand the conditions under which each enterprise is to be privatized. Understanding the conditions under which each individual enterprise is operating is a very important task before the actual decision is made as not all enterprises would qualify for outright privatization. Some of the SOEs have a network of subsidiaries, which would require time to dispose. It will also enable the practitioner to predict the success or failure of the privatization of specific enterprise and its social impact if privatization fails. There have been cases where new owners are not interested in the
continuation of an SOE operation but rather are interested in the land that the asset occupies. Thus, this requires a case-by-case analysis as each enterprise is unique.

### Diagnostic Matrix

<table>
<thead>
<tr>
<th>EXTERNAL/ MACRO DIMENSION</th>
<th>LOW</th>
<th>HIGH</th>
</tr>
</thead>
<tbody>
<tr>
<td>LOW</td>
<td>Inefficient operation</td>
<td>Inefficient operation</td>
</tr>
<tr>
<td></td>
<td>Less Social Significance</td>
<td>High Social Significance</td>
</tr>
<tr>
<td>HIGH</td>
<td>Efficient Operation</td>
<td>Efficient Operation</td>
</tr>
<tr>
<td></td>
<td>Less Social Significance</td>
<td>High Social Significance</td>
</tr>
</tbody>
</table>

#### Figure 3: Diagnostic Matrix

The above diagnostic matrix captures the international stakeholders (external) and internal conditions as well as domestic stakeholders as explained by Stalling and Peres (2000). The matrix also captures the inherent conflict of policy change and calls for consensus as pointed out by Van Meter and Van Horn (1975).

The above diagnostic matrix captures the international stakeholders (external) and internal conditions as well as domestic stakeholders as explained by Stalling and Peres (2000). The matrix also captures the inherent conflict of policy change and calls for consensus as pointed out by Van Meter and Van Horn (1975).
3.3 Policy Implications

Since not all the enterprises under consideration for privatization have the same set of conditions, we need to develop a different strategy for different enterprises, which have different conditions in terms of their operational efficiency and social impact. By making use of the same matrix developed for analyzing the condition for each enterprise, we can draw a policy matrix for the selection of privatization methods for each enterprise under consideration. Figure 4 below depicts this extension. On the vertical axis is the enterprise efficiency level as well as the level of social significance to domestic stakeholders. This is portrayed as 'high' and 'low'. The horizontal axis captures the level of social significance and at the same time the role of external (international stakeholders) that have been at the forefront in advocating privatization policies.

![Policy Matrix](image)

Figure 4: Policy Matrix
Building a more effective model of implementation requires a much more careful evaluation of a policy's characteristics. The external/macro dimension and internal/micro dimension model presented here is a contingency model that attempts to provide a more comprehensive and coherent basis for understanding implementation of privatization programs.

Even after privatization as a concept has been internalized by policymakers, debate often continues around issues like the divestiture sequence, size of the firms to be sold and the speed at which privatization is to be undertaken as well as the method to be used. In many countries in Sub-Saharan Africa, the divestiture of small firms is almost exclusively sold to 'nationals' or simply liquidated and this attracts little attention even when they end up in the hands of bureaucrats and politicians. It is the privatization of large firms especially those thought to be 'strategic' that leads to controversy (Grindle, 1980). First, these enterprises are too big for domestic capitalists to afford and thus end up in foreign ownership. Second, the concept of 'sunk cost' is not well-appreciated by the general populace and the politicians. The public expects large state-owned enterprises to be worth at least a good portion of the millions spent on their rehabilitation or on loans to them by the government. The sale of a 'national treasure' at a 'distress' price causes much political dissatisfaction. In defense of these concerns, many African governments embarked on privatization with two sets of list which, in the case of Kenya, contained 'non-strategic' enterprises (207 of them), which were to be privatized immediately and a second list of 'strategic' enterprises (33 of them) were to remain in state ownership. This list includes among
others, Kenya Port Authority, Agriculture Development Corporation; Kenya Railways and National Cereals and Produce Board. In this model, the state lies at the center of the formulation and implementation of the adjustment strategy. It must negotiate and bargain at both levels of politics; that is, with its domestic constituents and with international actors.

As already noted, the multinational agencies and donor community are very much involved in the implementation of privatization in many African countries. They help set up and finance the institutional structure for privatization and ensure that the process remains on track by attaching it to their overall conditionality.

With the help of Figure 4, I identify four implementation perspectives for a typical country like Kenya. On the vertical axis of Figure 4 is the internal/micro dimension which ranges from high to low. This shows the degree of operational efficiency of an enterprise and is an indicator of the likelihood that an enterprise will survive in a competitive global economy. On the horizontal axis is the external/macro dimension measured from low to high and is an indicator of the relationship of the enterprises with its external stakeholders and the society and reflects the degree of significance of the enterprise in the society.

Details of the four perspectives are as follows:

1. The ‘Keep Public’ (maintain as public) describes a position that is dynamic and requires consensus between external stakeholders (donors/financing agencies), the government, and the society. An enterprise with a high degree of social significance but possessing a low level of operational efficiency
would be placed in this first quadrant. The typical example of this type is the agriculture industry. Agriculture, due to the necessity of its nature, possesses a high degree of social significance. The agriculture industry comprises large scale and smallholder farms and both are highly dependent on subsidies from the government in form or low input prices, soft loans and other services. This type of intervention is not confined to Kenya but is a worldwide phenomenon. If fully privatized, an industry in this position may not survive for long and create massive social problems or at best would require continuous government subsidies. A typical example of this kind is National Cereals and Produce Board (NCPB).

2. The ‘Let Die’ position refers to a scenario quite common in Sub-Saharan Africa, where the governments embark on rapid privatization of small firms, but balked when it came to large enterprises. This was the experience in Kenya during the initial years of privatization program in the early 1990s. Most of the small enterprises were either liquidated or put in receivership and later sold quietly. Many of the enterprises were non-operational at the time of privatization; however, the general public still believed that they were worth much more than the buyers were offering and hence valuation of assets has continued to be a thorny issue. An enterprise in this category exhibits both a low level of the external/macro and internal/micro dimension evaluation criteria, and therefore falls into the least favorable quadrant of the Practitioner Privatization Model. Maintaining this type of industry, which is very
inefficient and bears little social significance will eventfully drain the nation's wealth and will be a serious burden to the whole society. The low social significance implies that consumers have alternative sources of supply at market rates.

3. The third category in the practitioner model is ‘Market Approach’ in Figure 4. This characterized the bulk of Sub-Saharan countries in the first half of the 1990s. In Kenya the government had extended it activities in almost every sector of the economy. Some of the activities it engaged in had low social significance; for example, the hotel industry and poultry industry. In spite of privatization being accepted in principle, it was still difficult to carry out the implementation. Some enterprises were considered as symbols of national independence and carried considerable sentimental value to the Kenya people; privatization became a slow process. However the government was able to privatize Kenya Airways using the market approach. Another example of a successful implementation of the market approach is given by the employee buyout of the Ark Limited (a hotel in the Tourism industry in Kenya). The hotel was owned by the Kenya Tourism Development Corporation and was one of the first enterprises to be privatized, experiencing positive results (PERP 1999).

4. The last position referred to as ‘Gradual Approach.’ So far only a few sub-Saharan countries have realized the benefits of this position. The position involves a full fledged privatization effort, including firms formerly
considered strategic in sectors such as telecommunications, electricity, water and other utilities. The position is realized when political and institutional constraints have been resolved and the private sector is ready to take over. However, even if an enterprise in this category is operationally efficient, because of its high social significance, if privatization fails, it can cause serious social problems including massive unemployment and social disruption, characterized by riots in Africa. There are not many examples in Kenya due to the general poor performance of SOE but Kenya Cooperative Creameries would be a fair example.

The next chapter expands on the four implementation perspectives and provides specific examples for each category. Descriptions of the implementation process with special emphasis on the factors that have had significant influence are discussed.

3.4 Methodology

This study focuses on issues relating to policy implementation of privatization of SOEs in Kenya. A single country case study method is used to investigate the research questions. Case studies are traditionally regarded with serious reservations because of concerns about scientific rigor and the extent to which the conclusions can be generalized (Yin 1994; Van Evera 1997). However, scholars have argued that the case study has its advantages and strengths and can satisfy a number of sound scientific purposes (Van Evera 1997, 55-74). In some instances it is the best research method available; it cannot only contribute 'uniquely' to our understanding of complicated political processes and events (Yin 1994), but can 'supply quite decisive
evidence [to test] political theories' (Evera, 1997). Finally, provided the critical distinction is made between 'statistical generalization' and 'analytical generalization,' the latter being better suited to case studies, the findings and conclusion of even single case studies may be generalized and used in theory-building (Yin 1994: 31-32).

Kenya provides lessons relevant to the SOE problem in other African countries. The shocks that Kenya suffered during 1979-1983 were similar to those suffered in the rest of the region. Kenya as a nation has made substantial efforts and also has encountered considerable obstacles in its recent privatization initiative and thus provides a useful instance to elaborate and extend the broad theoretical point of public-private interdependence. Kenya has also made significant progress in implementing stabilization and structural adjustment reforms. While growth rates have risen, they have not been high enough to pull the country out of poverty and debt. Macroeconomic shocks have microeconomic consequences, and the SOE suffered along with the rest of the economy. Price policies that fixed public enterprise prices while leaving private firms more flexible have been a common phenomenon throughout Africa. Kenya has a unitary structure of administrative power. This fact eliminates problems in intergovernmental relations concerning the articulation and implementation of privatization. Finally, Kenya like many other developing countries is highly susceptible to pressure from international financial institutions, which affect its privatization decisions.

In order to provide some concrete examples of the manner in which state-civil society and international actors have interacted as the implementation process moved
through, and the strategy the country took, I will look at five state enterprises out of
the possible 240. Due to time and resource constraints I have limited the review to the
five: (1) National Cereals and Produce Board, (2) Kenya Cooperative Creameries, (3)
Kenya National Transport Company, (4) Kenya Airways, and (5) Telkom Kenya. The
selection is intended to allow us to examine alternative possible organizational
arrangements for service provisions in different political and economic circumstances,
and also to examine whether there are organizational practices that seem to be more
appropriate to particular services or in the national context.

The five enterprises were selected because they presented different ‘technical’
cases for government intervention given the likelihood and form of possible ‘market
failure’. While none of them are pure ‘public goods,’ the sectors can be seen as being
on a roughly declining scale from a stronger to weaker case for government
involvement.

The examples provide an opportunity to look at how and why different
institutional changes occurred for each one. It permits a focus on the interplay
between institutional change and constraint and the actions of state, civil-society, and
international actors. In particular, the exogenous conditions were similar in all cases
and this allows the analysis to focus on endogenous factors and the role of internal
actors.

The two examples of NCPB and KCC represent a comparison of the “most
similar” case (Przeworski and Teune 1970) that illustrate an ideal combination of
factors for the study of the issues raised in this research. The structure and mission of
the two agencies are similar. The agencies are trading and marketing bodies only. Neither engages in agriculture directly; they both purchase agriculture/farm produce from farmers and groups of farmers. Each transports, stores, processes, and markets the produce of thousands of small scale farmers. They are both in the agricultural sector and play an important role in food security in Kenya.

The sources of information used in this study are government policy framework papers, policy statements, development plans, World Bank and IMF papers, academic journals, magazines, and newspapers as well as ongoing research of research institutes in Kenya and elsewhere on the subject. These documents and others obtained from other sources are supplemented by the author’s own research and work experience with Kenyan government. Using these multiple sources, I was able to obtain a more complete analysis of the political and administrative forces involved in implementation policies and procedures.

Documents were selected on the basis of their importance across the reform process, their ability to provide an historical perspective and their accessibility. From this type of material I have been able to review various theoretical frameworks that have been used in an attempt to explain factors that have contributed to different responses to the implementation of SOEs. By attempting to get this documentation to “speak for itself,” I have sought to identify and analyze patterns of constraints and achievements to address the challenges. By using this documentation, factors hindering implementation are identified. They range from the ways privatization policies are formulated to the way they are endorsed and backed-up by various actors
in society, to the way they are actually implemented at the enterprise level. This is an important case example that aims to provide a context for the analytical discussion of issues relating to SOE ownership, strategy and implementation status. I recognize that the approach to use reviews particularly that of multilateral and bilateral agencies limits me to documenting their experience; however, the government has been a full participant, albeit a silent one in some occasions of the various reports and memorandums.

Chapter Four lays out the context of Kenya’s SOE reform program, followed by Chapter Five, which uses the framework discussed above to analyze issues arising during the implementation of privatization process of the selected SOEs in Kenya.
CHAPTER IV

THE CONTEXT FOR KENYA'S SOE REFORM PROGRAM

"For economic reform to take root, you must have a leader with a higher profile and clout to generate support for change within the civil service, manage opposition to change, empower and protect hardworking civil servants and deal with actions which threaten to derail reforms...The scope of reform we want to implement will need civil servants who will be prepared to take bold economic decisions even when those decisions threaten the vested interests of powerful politicians."

(Mr. Kisero, Managing Editor of The East African. Retrieved on 12/28/05; http://www.nationmedia.com/dailynation)

4.1 Introduction

This chapter examines the factors that have influenced implementation of the privatization reform program of SOEs in Kenya. Although the study is interested mainly in the 1979-2002 time period, this chapter addresses the pre-1979 period because many of the issues currently affecting implementation are leftovers from the first post-independence administration as well as colonial era, an historical perspective where the previous regimes established certain development structures and patterns of regional resource allocation, many of which continue to influence current trends.

1979 is an important year in the history of Kenya. It marked the first full year of the second president of the Republic, who remained in power throughout the time period covered by this research and which coincided with the start of structural adjustment program. The fourth National Development Plan (1979-83) was the first
document to enunciate a more open strategy for the industrial sector. In addition, the second oil shock in 1979 contributed to a rise in balance of payment current account deficit from 3 percent of GDP in 1975-77 to 10-11 percent in 1978-82 (O’Brien and Ryan, 1999).

Following independence in 1963, the Kenyan government devised strategies to achieve three goals that were considered imperative for development: (1) a fast overall economic growth rate, (2) equitable distribution of development benefits, and (3) Kenyanization of the economy (GOK, 1965). Import substitution industrialization policy was explicitly made the cornerstone of the government’s economic strategy for realization of these goals. To implement this policy, the new government counted on a wide array of instruments such as exchange controls, import controls, and export promotion, industrial promotion including over one hundred state-owned enterprises (SOEs). From 1965 onward, the government actively expanded and strengthened SOEs as the vehicle of development and Kenyanization.

The 1980s saw a paradigm shift in the global politico-economic system, which emphasized reforms that favored the market economy. The thinking advocated by institutions such as the World Bank and the International Monetary Fund (IMF) led to the introduction of Structural Adjustment Programs (SAPs) that pushed for liberalization of economies in terms of removing impediments that would hinder open market capital flows to pave the way for private sector participation. The global wave of privatization seems to give credence to theories of policy convergence over those of partisan policy-making (World Bank, 1981). This study argues that not all
governments implement privatization in the same way, even in the context of policy convergence.

4.2 Implementing Privatization

Privatization has been an element of a broader modernization program of structural adjustment focused on replacing the statist economic model with one that would, according to liberalization, best utilize resources, increase efficiency, and modernize industry. Principally the goal has been to redefine the state’s role in the economy, thereby increasing competition, reducing subsidies, decreasing the fiscal deficit and overall debt and promoting macroeconomic stability. The state would retain public enterprises that were strategic (i.e., related to national sovereignty) or high priority (i.e., of significant social benefit).

A radical change in the official perception of the role of public sector was contained in the Sessional Paper No. 1 of 1986, which outlined economic policies and strategies that would guide the country up to the turn of the century. The document explicitly stated that all of the country’s basic industrial development goals were to be achieved through private sector enterprises, pointing out that “in the face of severe fiscal stringency, direct investment by the government in modern industry would be uneconomic use of scarce public resources…and that direct intervention by government in investment production and pricing also diverts scarce public managerial capacity from completing essential tasks…” (GOK 1986, p. 92).

The Kenyan government outlined a privatization strategy in its 1992 parastatal reform program The Policy Paper on Public Enterprise Reform and Privatization as

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well as the *Policy Framework Paper of 1993-96* (GOK, 1992; 1993). Under these policy documents, the government would exit from commercial institutions, scrap or sell non-strategic parastatals and merge all SOEs with similar roles. Among other key measures, the policy papers recommended (a) the separation of ownership from management and (b) the enhancement of autonomy, professionalism and accountability of management.

Unfortunately, in the decade between 1992 and 2002, the promises of the policy paper were honored more in breach than in fulfillment. In the absence of a binding and regularly followed privatization law, the process has been intermittent, mainly driven by political expediency, donor financial carrots and the commercial interests of politically connected investors. The key instrument for implementing privatization has been the Parastatal Reform Program Committee (PRPC) and its secretariat- the Executive Secretariat and Technical Unit (ESTU).

The tables below provide a summary of privatization activity in Kenya up to 2002.

**Table 2: SOEs Privatized by Sector, 1992-2002**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture Production &amp; Processing</td>
<td>71</td>
</tr>
<tr>
<td>Financial</td>
<td>11</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>57</td>
</tr>
<tr>
<td>Services</td>
<td>41</td>
</tr>
<tr>
<td>Trade</td>
<td>7</td>
</tr>
<tr>
<td>Other</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>188</strong></td>
</tr>
</tbody>
</table>

*Source: African Development Indicators, World Bank, 2004, p.262*
Table 2 shows the total number of privatizations by sector in which the privatization has taken place. There were 207 SOEs that were targeted for privatization, which means over 90 percent of the target was achieved at the end of 2002. Table 2 also shows that the agriculture sector has had the highest number of SOEs privatized. This is expected given the dominance of the sector in the economy.

Manufacturing has been affected by the liberalization measures and most of them could not withstand the competition from imports as well as changes in technology. This is reflected in the high number of privatized enterprises as shown in Table 2. In absence of a legal framework governing privatization, the government has used a mixed-bag of instruments and measures. These have included competitive sales, public floatation, majority exercise of pre-emptive rights, liquidation etc. The main methods used to privatize are detailed in Table 3 below.

Table 3: Divestiture Methods Employed up to 2002

<table>
<thead>
<tr>
<th>Method</th>
<th>No of Enterprises</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of Shares:</td>
<td></td>
</tr>
<tr>
<td>• Competitive sales</td>
<td>13</td>
</tr>
<tr>
<td>• Pre-emptive rights*</td>
<td>96</td>
</tr>
<tr>
<td>• Public floatation</td>
<td>16</td>
</tr>
<tr>
<td>Sale of assets:</td>
<td></td>
</tr>
<tr>
<td>• Liquidation</td>
<td>36</td>
</tr>
<tr>
<td>• Competitive sales</td>
<td>17</td>
</tr>
<tr>
<td>• Direct sales</td>
<td>4</td>
</tr>
<tr>
<td>Other methods:</td>
<td></td>
</tr>
<tr>
<td>• Management contract</td>
<td>2</td>
</tr>
<tr>
<td>• Debt/equity swap</td>
<td>1</td>
</tr>
<tr>
<td>• Others</td>
<td>3</td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td><strong>188</strong></td>
</tr>
</tbody>
</table>

Source: African Development Indicators, World Bank, 2004, p.262
*pre-emptive rights- shares are sold to existing shareholders as per provisions governing pre-emptive rights. The price per share may be set out in the Company Charter/Articles of Association or simply negotiated.
The methods that the government has used to dispose of SOEs has included competitive sales, public floatation, majority exercise of pre-emptive rights, liquidation etc. Use of these methods ultimately altered the final composition of government control over the privatized SOE. In some cases, the government simply transferred majority shares to private agents, while in others it continued to maintain majority ownership of the privatized SOE. Any shares above 51% are considered majority holding and this gives the government the power to appoint the chief executives.

By the time the first phase was completed in 2002, the program had raised Kenya Shillings 10.4 billion (US$ 248 million) with 188 transactions (ROK 2005). The implementation of the second phase planned for the period 2005-07 received a boost with the enactment of a Privatization Bill in 2005.

The program has had a number of weaknesses. In spite of the number of enterprises privatized, the impact to the economy has been limited. This is because most of the enterprises privatized were relatively small and self-sufficient. As such most of the companies, which were a drain to the treasury, and on which significant efficiency gains could have been achieved and for which financial management resources would have been attracted were not affected. In addition, the fact that the institutional framework outlined in the policy paper was not entrenched in the law, made the program unsustainable financially (ROK, 2005). Research findings by the Centre for Governance and Development (CGD) for the period 1993-2002 indicates that up to 54 billion shillings may have been lost by 12 SOEs under the category of
strategic.’ Table 3 below shows what CGD considered the most wasteful corporations.

Table 3: Best Corporations & Amount Lost

<table>
<thead>
<tr>
<th>Rank</th>
<th>Corporation</th>
<th>Probably Lost*</th>
<th>Certainly Lost*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>K.P &amp; T. C</td>
<td>25,564,372,988</td>
<td>590,645,032</td>
<td>24,155,018,020</td>
</tr>
<tr>
<td>2</td>
<td>National Social Security Fund</td>
<td>5,872,807,216</td>
<td>7,415,668,636</td>
<td>13,288,475,852</td>
</tr>
<tr>
<td>3</td>
<td>National Cereals &amp; Produce Board</td>
<td>2,127,766,885</td>
<td>889,484,989</td>
<td>3,017,251,874</td>
</tr>
<tr>
<td>4</td>
<td>Kenya Ports Authority</td>
<td>695,078,350</td>
<td>1,496,406,168</td>
<td>2,191,484,518</td>
</tr>
<tr>
<td>5</td>
<td>Kenya Railways Corp.</td>
<td>2,131,215,023</td>
<td>48,870,181</td>
<td>2,180,085,204</td>
</tr>
<tr>
<td>6</td>
<td>Agricultural Finance Corp.</td>
<td>1,427,168,000</td>
<td>0</td>
<td>1,427,168,000</td>
</tr>
<tr>
<td>7</td>
<td>Industrial &amp; Comm. Dev. Corp.</td>
<td>0</td>
<td>889,566,980</td>
<td>889,566,980</td>
</tr>
<tr>
<td>8</td>
<td>National Oil Corporation</td>
<td>618,351,965</td>
<td>168,545,201</td>
<td>786,897,166</td>
</tr>
<tr>
<td>9</td>
<td>Kenya National Trading Corp.</td>
<td>351,065,806</td>
<td>426,674,062</td>
<td>777,739,868</td>
</tr>
<tr>
<td>10</td>
<td>Lake Basin Dev. Corp.</td>
<td>543,343,671</td>
<td>46,633,093</td>
<td>589,976,764</td>
</tr>
<tr>
<td>11</td>
<td>Kenya Airport Authority</td>
<td>114,919,923</td>
<td>376,423,623</td>
<td>491,343,546</td>
</tr>
<tr>
<td>12</td>
<td>Milling Corp. of Kenya</td>
<td>400,280,000</td>
<td>401,777,781</td>
<td>802,057,781</td>
</tr>
</tbody>
</table>

Source: Centre for Governance and Development, Nairobi, 2005 (Table 10 p.12)

Table 4: Amount Lost by the Twelve Most Wasteful Corporations

<table>
<thead>
<tr>
<th>Rank</th>
<th>Corporation</th>
<th>Probably Lost*</th>
<th>Certainly Lost*</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
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<tr>
<td>5</td>
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<td>2,131,215,023</td>
<td>48,870,181</td>
<td>2,180,085,204</td>
</tr>
<tr>
<td>6</td>
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<td>1,427,168,000</td>
<td>0</td>
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<td>Industrial &amp; Comm. Dev. Corp.</td>
<td>0</td>
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<tr>
<td>10</td>
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</tr>
</tbody>
</table>

The data reveal that the twelve corporations accounted for 93% of the total parastatal waste; the top six accounted for 85% and the Kenya Posts and Telecommunication and the National Social Security Fund accounted for 70% of the value of reported waste (CGD 2005).
4.3 Major Features of Kenya’s Political Economy

Before discussing the challenges of implementing privatization reform program of SOEs, I wish to highlight some of the major determinants of Kenya’s political economy. There is no consensus in the literature on Kenya’s political economy about the main forces that determine and shape program implementation in the country. In some cases this literature is characterized by contradictory interpretations of the main forces of Kenyan politics. While these differences may reflect the ideological leanings of the analysts, they also may be simply a reflection of the failure by scholars to fully understand the complexity of the forces that combine and the ways in which they combine and interact to influence politics and resource allocation in Kenya.

Despite this, four broad approaches that have dominated the literature on the political economy in Kenya are identified: 1) class, 2) ethnicity, 3) patron-client networks, and 4) the economy of affection. Each of these is briefly discussed below.

4.3.1 Class and Resources Allocation in Kenya

The class approach associated with Brett (1973), Leys (1974, 1978), Langdon (1975, 1977), and Swainson (1980), among others, argues that it is the interest of the ruling and economically powerful class to determine the way public resources are distributed in Kenya. According to this approach, the distribution of public enterprises and economic services are concentrated in the areas in which the rich and politically powerful reside.
Although there has been some disagreement among scholars about the nature of classes in Kenya (Bates, 1989; Himbara, 1994; Kimenyi, 1988), the literature associates their emergence with the economic development policies pursued during the colonial and post-colonial periods. For example, Hazelwood (1979) stated that the colonial class structure had the following characteristics:

A fundamental determinant of the nature of Kenya’s political economy and of government policies was the existence of a wealthy non-African communities consisting of 61,000 Europeans, at the helm of both economic and political power, 169, 000 Asians immediately below the Europeans and about 7.8 million Africans at the very bottom of this racially determined class structure. Most development policies, institutions and infrastructure were developed as instruments for European advancement (p.7).

Although the attainment of political independence in 1963 resulted in the transfer of political power to Africans, the class nature of the state was maintained and enhanced by the development policy adopted by the first post-independence government. The policy emphasized economic growth through the citizen participation in public and private sector initiatives. Private sector involvement could either be by individuals or by companies or both. The government also encouraged private foreign investment as a partner in Kenya’s development efforts. Again, this would operate either independently or in collaboration with local investors. In short, Kenya adopted a mixed economy. The details of this policy were stated in Sessional Paper No. 10 of 1965, a policy document that has guided the country’s development orientation since

72
that time (GOK 1965). Thus, the government's economic development goals have always been driven by a national desire to (a) accelerate economic social development; (b) reduce poverty and redress regional economic imbalance; (c) increase Kenyan citizens' participation in the economy; and (d) promotion foreign investment.

The Kenyatta regime supported the utilization of foreign capital and other resources and resisted any suggestions to nationalize foreign companies. This position was based on the commonly held theory in the 1960s that what was hindering the development of the Third World was lack of capital and technical know-how; consequently if these were to be made available, Africa would modernize. Thus, Kenyatta was to emphasize that "as with capital we can now grow rapidly only by supplementing our meager supply of domestic trained manpower with large numbers of people from abroad" (ROK, 1965 p.21). Through joint ventures that brought in much-needed technology in addition to investment allowances to encourage foreign direct investment and with political stability, new capital was attracted to Kenya.

While this is not the place to critically examine the merits and demerits of this approach, suffice it to note that it led to a number of developments that are relevant for the present study. More specifically, it led to an increased penetration of foreign aid in Kenya in the form of capital, personnel, and technology. As a result, Kenya became almost totally dependent on foreign aid for its development. According to a Treasury official, 85 percent of government expenditures on development projects were covered by foreign aid (O'Brien and Ryan, 1999). Oyugi (1973), Holtham and
Hazelwood (1976) observed that donor penetration has resulted in donor influence on the public policy process in Kenya. The present study explores this observation further by examining the role played by donors on SOE reforms and the implementation of privatization program. In particular, I examine the ways in which this dependency has affected the political flexibility of the Kenyan regime as it attempts to implement the policy of SOE reform in particular and other SAPs in general.

The point, however, is that the ruling class either independently or in collaboration with foreign capital has been much more concerned about their own interests than about promoting equity. The result is the glaring inequalities in the distribution of resources and services in rural and urban areas. The number of people living in poverty is estimated to have risen from 11 million or 48 percent of the population in 1990 to 17 million, or 56 percent of the population in 2001 (MPND, 2003). The Welfare Monitoring Survey in 1994 estimated that 43% of Kenya was living in conditions of absolute poverty, a small reduction in the incidence compared to 1982. The number of absolute poor increased to 12.6 million in 1997, from 11.5 million in 1994 of the total population of 28 million and 26 million respectively (UNCCA, 1998). Poverty, therefore, continues to be the biggest challenge in the development of Kenya.

Different regions also benefit differently from public policies. Most of these benefits are allocated to favor the interest of the ruling class. It is imperative to point out that policy decisions in Kenya are made not through public debate but by
government officials and the political elite, often through presidential directive at
highly-charged political rallies. The ordinary citizens play no direct role in this
process. While this is not disputable, the issue of interest for this study is the
determination of the factors and considerations that influence the behavior of these
officials as they make public policy decisions. Is it purely class interests, ethnicity,
national interests, the interest of the leaders, or a combination of some or all of these?

Class interest has also been used to explain the urban bias of most public
policies in Africa in general. Bates (1981), for example, has presented a compelling
and powerful argument backed with examples from Kenya and other African
countries to show that governments in Africa respond to fears of urban unrest by
advocating policies aimed at reducing the cost of living and in particular the cost of
food in order to appease urban workers (Bates, 1981). It is important to note,
however, that not all urban residents benefit from the so-called urban-bias policies.
Urban areas in Kenya and in many other parts of Africa are home to some of the
poorest and economically marginalized groups in society.

4.3.2 Ethnicity and the Distribution of Resources

An alternative that tries to explain how allocation policy decisions are made
focuses on Kenya’s social structure. This approach identifies ethnicity as the most
important determinant of resource allocation and distribution in Kenya. Scholars
associated with this approach include Bienen (1974) and Throup (1987). Throup, for
example, has presented an elaborate and detailed account of how the first and second
presidents of Kenya attempted to promote the economic interests of their ethnic groups.

The second president defended his decision to shift resources away from the Central Province on the grounds that it would create some ethnic balance for equitable development in which there is equal opportunity for all (Barkan and Chege, 1989). Like the first president, he adopted the same patronage strategy of favoring his own ethnic community. Nguyi and Gathiaka (1992), for example, pointed out that “the Kalenjin ethnic group accounted for 25.1% of all the chairman and chief executive positions in the 150 parastatals surviving as going concern in Kenya...and that of a total of 85 profit-making parastatals, the Kalenjins alone controlled 40 of them (there are 42 ethnic groups in Kenya). By controlling the public enterprises, they were able to control some strategic sources of government revenue, public sector employment, critical linkages for the private sector, and a certain reward structure for the benefit of the Moi regime” (p. 6). Issues of ethnic favoritism in the allocation of resources have been subject of public comment in Kenya for many years.

4.3.3 The Economy of Affection and Resource Allocation

A slightly different approach focuses on the processes associated with the networks of support, communication, and interaction among structurally defined groups connected by blood, community and other affinities such as religion. At the national level these social bonds, which Hyden (1983, 1987) refers to as the economy of affection; translate into ethnic associations and solidarities binding both the rich and the poor. According to this argument, the attachment to one’s kinship group
would compel the rich, who also tend to control state resources, to share their wealth with the rest of their kin. This ensures a redistribution of resources not only between the rich and the poor but also among regions of the country since these networks are to be found among all ethnic groups. Leaders thus would feel pressured to use their public positions to direct resources to their own kinsmen because of these affinities. This makes it very important for a community, be it an ethnic group or a district, to have members of their group appointed to high positions in government. The point is that these ties do help in the distribution of resources.

4.3.4 Patron-Client Relations and Resource Allocation

The final approach I highlight describes Kenya’s political economy as patron-client relations. According to Barkan (1992), clientelist’s networks formed the mainstay of Kenyatta’s 15-year rule. Moi modified it but found that he also had to rely on clients across the country to provide the necessary political support for his regime. Through a hierarchy of patron-client networks, both Kenyatta and Moi were able to allocate resources to the regions depending on how politically important each region and its local leaders were to the president. This approach thus places the leader at the center of resource allocation and would appear to support the theory of personal rule as developed by Jackson and Rosberg (1982). However, even the leader has to consider other factors and actors as well, especially those deemed to be critical for his or her survival as head of state.

The relevance and role of patronage in resource allocation in Kenya is perhaps best demonstrated by the way Moi used the harambee movement (self help) during
his tenure. He used the movement to initiate and conduct numerous fund drives for schools and hospitals in different parts of the country. The frequency of his visits to different areas was very selective. Regions considered not to have demonstrated adequate loyalty and support for his regime had fewer presidential harambees. It is important to note that some of the money contributed by the president to these harambees came from the treasury through the various ministries.

4.4 An Interactive Approach to Kenya’s Political Economy

The argument of the present study is that even though each of these variables is useful, especially for analytical purposes, relying on one to the exclusion of the others oversimplifies the complexity of Kenya’s political economy. I argue in this study that neither class, ethnicity, economy of affection, nor patron-client relations taken singly can adequately explain the dynamics of Kenya’s political economy. Rather, they have to be seen as interacting in complex and interrelated ways to influence and shape the politics of the country and, in particular, the allocation and distribution patterns of SOEs. For example, it is not uncommon for members of the ruling class from one ethnic group to blame development failures in their region on elites from other ethnic groups.

The collapse in the 1990s of the multimillion shillings molasses factory project in Kisumu is a good case in point. It indicates political rivalry and the fragmentation of the ruling elite in their effort to destroy each other’s political base by frustrating the development projects. The completion of the project would have provided employment opportunities for a large number of small scale farmers and
local communities. It would also have contributed to the general development of the area hence the determination to frustrate its completion in order to punish those who did not support the regime.

The interactive complexity, fluidity, and dynamic nature of the forces of class, ethnicity, affective ties, and even patron-client relations makes it very difficult to develop a predictive analytical model that would help us to predict how and when one variable will be abandoned in favor of another in the implementation and allocation process. The problem becomes even more apparent when political and other public institutions are rarely used as means to decision-making.

4.5 The State in Kenya's Political Economy

The final comment regarding Kenya's political economy is that the state remains the single most important source of resource allocation. It is the major employer and until recently, the dominant provider of services such as education and health care and guarantor of affordable basic food prices. Therefore, control of the state becomes critical as it facilitates the control of resources for personal wealth and for buying political support.

4.6 Domestic Political Challenges

Several related developments in the domestic political context emerged in Kenya after the introduction of the SAPs. These included discontent with the government amongst the general population due to price increases and introduction of cost sharing in education and health services plus reduction in many other services
particularly in agriculture, a rise in ethnic tensions, and transition to democracy accompanied by the emergence of a vocal political opposition. Each of these factors challenged the stability of the regime, and weakened its commitment to sustain the rapid pace of the structural adjustment reform as recommended by the IFIs as more resources were diverted to maintenance of security especially after the attempted coup in 1982.

Numerous protests over various issues have taken place since the initial implementation of reforms. Demonstrations, which mostly originated at the University of Nairobi, quickly spread to other campuses throughout the country. These protests evolved into serious ethnic clashes in 1992 and 1997, and leaflets critical of the government continued to be distributed in one form or the other throughout the period under consideration.

Under the first regime, ethnic strife, though present, was suppressed by a policy that placed Kenyan nationalism above all ethnic differences. With the new regime, however, ethnic tensions resurfaced as it campaigned on ethnic sentiments. In Kenya the main ethnic groups in national political life are the Kikuyu (the group of the first president), the Luo, the Luyha and the Kalenjin (the group of the second president). The fact that some of the ringleaders of the failed 1982 coup attempt were mainly from Kikuyu and Luo ethnic groups made president Moi suspicious that these two ethnic groups were plotting to over through him and he thus did not appoint many to government posts and those who held senior positions were removed.
The transition to democracy and the emergence of a vocal opposition represented the third development in Kenyan domestic politics since introduction of the SAP. In late 1991, the government lifted the ban on opposition parties in preparation for the first multiparty elections in December 1992. The announcement of the move was to placate the international donor agencies who had suspended credit to the government. By early 1992, there were over 40 political parties registered for the 1992 presidential and legislative elections. The president also announced that the time was right for Kenya to start drafting a new constitution. This was in the making for over 15 years. In October 2005 the new constitution was completed and circulated to the public in November 2005. The public rejected it on some contentious issues regarding the position of prime minister and the powers the holder would have compared to that of an elected president.

4.7 International Donor Impact

In addition to setting the SAP agenda and affecting the implementation of certain measures, external donor behavior had a broader impact on the reform program. Donor commitment in the form of financial support, the heavy presence of foreign experts, and poor coordination amongst donors in Kenya all affected the nature of the relationship between the donors and the government regarding the reform program.

Kenya has for many years received aid from virtually all aid-giving nations and agencies. There are obvious reasons why Kenya has received large inflow of aid for many years from a wide range of aid partners. The primary motivations for
providing aid are developmental, commercial, and political. First, the government's management of the development was prudent and the economic track record was relatively good, at least through the 1970s. Entering the decade of the 1980s the Kenyan economy had suffered; within a short span of 3-4 years, a series of economic shocks which were far more severe than any problems previously confronted in the post-independence era (O'Brien and Ryan, 1999). Despite a mixed record on economic policy reform and macroeconomic outcomes in the 1980s, the record was better than most of SSA. Kenya was for many years a relatively attractive locale for foreign investment, at least within the SSA context, especially for consumer goods industries targeted at the East African market prior to the collapse of the East African Community (EAC) in 1977. Finally throughout the years of the Cold War, Kenya enhanced its political importance by aligning itself with the West both economically and politically.

However, the end of the Cold War in 1989, which essentially eliminated the geopolitical motivation for aid, coincided with a weakening of economic reform efforts and a deterioration in economic performance in 1989-92, as a result of drought and increase in oil prices due to war in 1991, as well as a hardening of political lines within the country at the same time that donors were adding 'good governance' and democratization to their criteria for judging the worthiness of aid recipients. The result was intensification in the 'stop-go' relationship between donors and the Kenyan government, which has persisted to the present time.
Kenya's experience with external donors regarding adjustment has been characterized by extreme dependence. Insufficient levels of foreign aid after the end of cold war, poor coordination of that aid, and heavy donor presence, which often causes widespread anxiety within African governments and amongst the general population over reform program, were especially pronounced in Kenya. This was due partly as a result of government's rocky relationship with the IFIs, which negatively affected the government's ability to maintain political legitimacy with the people, and thus its ability to remain firmly committed to the SAP. The IFIs had added good governance in their list of conditions for additional funding, which the regime was not ready to comply with hence the deterioration of the relationship.

4.8 Institutional Structures for SOE Reform

The government acknowledged the need to undertake SOE reforms in 1979 (ROK, 1979), and as a result, a number of institutions were created to handle the task. Soon after the 1979 report on parastatal bodies, the Parastatal Advisory Committee (PAC) was formed and charged with the responsibility of providing advisory and supervisory services aimed at raising the efficiency of parastatals in the country. In addition to PAC, measures were taken to enlarge and strengthen the Inspectorate of Statutory Boards, which was expected to provide management, auditing, and consulting services to parastatal enterprises as well as act as a unit that would help sort out specific problems affecting parastatal.

The search for more effective institutional structures continued in the 1980s as the above structures failed to diminish those problems contributing to the poor
performance of parastatals. Thus in 1983, a Task Force on Divestiture was created following the recommendations of the Working Party on Government Expenditures (ROK 1982). One of the main tasks of the Task Force was to classify parastatal enterprises into four categories. Those to be retained by government, liquidated, merged with ministerial activities, or privatized. The report of the Task Force was, however, never released to the public.

The enactment of the State Corporation Act (CAP 446) in 1986 was one of the major efforts made by the government in the 1980s to streamline and strengthen institutional structures to facilitate parastatal reforms. The Act attempted to delineate the powers of parastatals in order to create an enabling environment for them to make decisions and created a number of agencies to provide management and supervisory services to the parastatal sector. The Act gave parastatal enterprises powers to hire general staff and chief executives, and to determine their wage rates within broadly defined limits (GOK 1986).

The Act also created the office of Auditor-General (Corporations) to help improve auditing of these enterprises. Auditing of parastatals was previously under the Auditor General which was responsible for both central government and local governments, and parastatals audit. Due to manpower, financial and other constraints, the Auditor-General (Corporations) was not able to improve the auditing service for the parastatals as had been expected (GOK 1998).

The Parastatal Review Committee was another institution which was created in the 1980s to improve the performance of the parastatals. As the momentum for
parastatal reform increased in 1990s, some new institutions were created to handle the process. One of the new key institutions created to guide the divestiture process was the Parastatal Reform Policy Committee (PRPC). The Committee brought together a number of ministries and other institutions closely associated with the divestiture program; however most of the divestiture activities have been under the Office of the President and Ministry of Finance.

While the government has made many pronouncements and taken measures to implement reform in the parastatal sector, there is still considerable skepticism about the government’s ability and willingness to implement the necessary reform program.
CHAPTER V

APPLICATION OF THE PRACTITIONER PRIVATIZATION MODEL

"Trade and Industry minister Mukhisa Kituyi yesterday defended new sugar importation policy introduced last week saying it was good for the country. Farmers led by Kenya Sugarcane Growers Association official Lucas Watta and other stakeholders have, however, rejected the new rules, saying they could lead to flooding of cheap imported sugar into local market and kill the multi-billion shilling industry. The farmers urged President Kibaki to intervene. Mumias Sugar Company chief executive Evans Kidero has however backed the policy introduced by Agriculture minister Kipruto Kirwa."

(Retrieved on 1/20/2006; http://www.nationmedia.com/dailynation)

5.1 Introduction

The Government recognizes the crucial role that efficient enterprises can play in promoting economic growth, poverty reduction, and eliminating contingent liabilities for the budget. Poor performance by key enterprises, especially in energy, telecommunications, agriculture, and transport has undermined the competitiveness of Kenyan goods and services. These have also made Kenya less attractive to investors (GOK 2002). It is this recognition that has informed the government’s privatization and public enterprises reform strategy. This chapter reviews five examples from different sectors of the economy in order to illustrate some of the fundamental problems and the potential application of the practitioner’s privatization framework developed in Chapter 3. The examples demonstrate the complex interplay of interest,
ideology and institutions in the five cases as exemplified by the epitaph to this chapter.

Examples of different SOEs demonstrate how they were affected by one or a combination of the variables that define the Kenyan political landscape. The selection of the cases is based on the enterprise's level of involvement in the adjustment process and in response to the research questions and propositions. In addition the availability of data was also a consideration. Two of the examples are drawn from the agricultural sector and their description is more detailed than the others since they have had a longer history, particularly with the external financiers. The examples drawn from the marketing boards in Kenya offer a unique opportunity to study the political economy of implementing privatization in a relatively homogeneous institutional setting and for enterprises that are relatively similar. This makes it easier to assess the motivation of politicians and compare the outcomes. The results should have implications for both Kenya's remaining SOEs and for other countries that have regulatory institutions in need of reform. In addition, the results might be generalized to state-owned enterprises in other sectors.

Based on the diagnostic and policy matrix of the Practitioner's Model, the selected cases, namely (a) National Cereals and Produce Board, (b) Kenya Co-operative Creameries, (c) Telkom Kenya Limited, Kenya Airways and (d) Kenya National Transport Company, cover all the four quadrants of the model, which illustrates the wide range of differences in terms of their operation and role in the economy. The model is used to generate different policy recommendations that
highlight the importance of the policy instrument used during the implementation and transition period. The cases show that different speeds of adjustment as well as implementation of reforms will have very different implications for stakeholders. This would support the proposition that adoption of reforms and the speed of implementation are determined by the level of economic crisis, external pressure, government commitment and the influence of the interest groups. In addition, the proposition that even in cases of reforms that are implemented as intended, implementation consists of a series of choices that are made by decision makers and policy managers in response to obstacles, changing conditions and divergent priorities will find support in the cases reviewed.

5.2 The Case of National Cereals and Produce Board (NCPB)

“Maize prices would not be allowed to go below Sh1, 300 per 90-kilogramme bag, Agriculture minister Kipruto Kirwa said yesterday...But Mr. Kirwa told maize farmers in the district not to sell their cereals at throwaway prices, but to store them until he announces the opening of the National Cereals and Produce Board (NCPB)...’You should not allow millers to take advantage of the liberalized market to exploit you, Mr. Kirwa told farmers’”. (Daily Nation Publication. Retrieve on 9/18/2006, http://www.nationmedia.com/dailynation)

5.2.1 Historical Background

Kenya has been undertaking a process of maize market reform since the late 1980s. The process has been slow and has been marked by a series of advances and
reversals, particularly regarding the amount of freedom the private sector was permitted in maize marketing. This reflected concern for maintaining the dominant position of the parastatal National Cereals Produce Board (NCPB) in the maize market.

Agricultural sector reforms have mainly been geared towards creating market competition through encouraging more private sector investments and participation. Attempts to open the grain market in Kenya to private traders go back to 1944. Such attempts have always been defeated by political opposition at the highest levels of government (The Courier, No. 114, (March-April) 1989) due to their involvement in the sector. The World Bank, in the early 1980s had pressed for maize market reform without much success (Mosley et al., 1991).

The official maize marketing arrangements in Kenya constitute a well-established interest of large farmers and top political elite (Toye 1992). The large farmers are an important part of the leaders’ agricultural power base (Mosley et al., 1991) as most of them come from the rural areas and own some of the big farms. The farmers also provide financial support to the political elite during their campaign for office. The National Cereals and Produce Board (NCPB) have been long established at the centre of the maize marketing system, controlling the purchase of maize from farmers and sales to millers. It has been a source of political patronage for various interests and persistently resisted reform attempts to abolish its maize monopoly (Financial Times, 1 Nov. 1993). The government never publicly supported reforms until 1995 when the president gave his support and subsequently the ruling party.
lack of support was due to fear of the social consequences in terms of unemployment and fear of being accused of selling national symbols. This political support came 15 years after the first structural adjustment loan (SAL) was given. Political support had thus been lacking all the time since SAPs began in Kenya in 1980.

Virtually all governments are confronted with the conflicting goals of maintaining food prices that are profitable for producers and affordable to consumers. In eastern and southern Africa this classic food-price dilemma has historically been dealt with through controlled marketing system

Current reform policy dilemmas in the agricultural sector in Kenya and in Sub-Saharan Africa in general are rooted in an historical context. Understanding the political and economic pressures that propel marketing reform policy in the region requires an understanding of (a) the role of food policy in the post-independence "social contract" between the state and the African majority, (b) policymakers’ belief and position toward reform, and (c) maize meal consumption pattern.

Maize is the strategic political crop in this region of Africa. Maize became the cornerstone of an implicit and sometimes explicit "social contract" that the post-independence governments made with the African majority to redress the neglect of smallholder agriculture during the colonial period. The controlled marketing system inherited by the new governments was viewed as the ideal vehicle to implement these objectives. The benefits of controls for settler farmers during the colonial era generated the belief that the same system could also promote the welfare of millions of smallholders if it were simply expanded (Jenkins, 1997). The social contract also

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incorporated the understanding that governments were responsible for ensuring cheap food supplies for the urban population. The cost of supporting smallholder production could simply not be sustained. Under increasing budget pressure and associated macroeconomic instability, international lenders gained leverage over domestic agricultural policy starting in the 1980s, which culminated in structural adjustment programs in the region (Jayne and Jones 1997).

Fiscal crisis and pressure from international lenders have been the principal driving forces behind food market reform. Policy reversals, state interventions, and inconsistent policy directions have characterized the reform process and underscore the fact that many government decision makers have not accepted the premise of the reforms and still mistrust the workings of markets as clearly demonstrated by the opening statement of this section.

5.2.2 External / Macro Dimension

Four implementation perspectives are developed in the practitioner privatization model developed for this study and based on external/internal configuration of the policy matrix in Figure 3. Each quadrant in the policy matrix represents a type of implementation process and the policy recommendation that is associated with analysis of the enterprise under consideration.

The National Cereals and Produce Board (NCPB) would fall under the category of high external/macro dimension for the following reasons:
- Aid-conditionality agreements pertaining to maize market reform commenced in the 1980s with the Sectoral Adjustment Loan from the World Bank (World Bank 1981).

- Fiscal crisis forced the government to accept the conditions of international lenders and donors to gain access to external financing. The conditions were mostly in the form of agricultural reform programs where NCPB has been the dominant organization (Jayne and Jones, 1997).

- NCPB has continued to support maize prices selectively in areas where the government derives its main political support.

- According to one study (Adedeji et al., 1990:50), Kenyan experience with structural adjustment programs teaches some lesson: that the economic crisis facing Africa has been caused by both internal and external factors.

- NCPB operations have depended on government subventions, hence the concern of international funding agencies and donors.

5.2.3 Internal / Micro Dimension

An enterprise with a high degree of social significance, possessing a low level of operational efficiency, would be placed in the first quadrant of the model. The recommendation according to the policy matrix is to “Keep Public” such an enterprise and in this case of NCPB, this should be a short term measure as explained in the policy alternative section.

The reasons for putting NCPB in the first quadrant are as follows:
Maize is the strategic political crop in Kenya and indeed in the sub-Saharan region. Maize became the cornerstone of an implicit and sometimes explicit "social contract" that the post-independence governments made with the African majority to redress the neglect of smallholder agriculture during the former colonial period (Jenkins, 1997).

Food security basically entails ensuring that adequate supplies of food are available in the market at reasonable prices, and that people have adequate means to acquire the food. Maize is the basic food staple in the diet of Kenyans, accounting for 36 percent of total calories. For people living at the poverty line, maize accounts for 58 percent of calories and 28 percent of food expenditure (Ministry of Finance, 2000).

Almost all rural households grow maize for consumption, and more than half are also net buyers. Among the lowest quintile of rural households, more than 80 percent are net maize buyers. Among urban household, virtually all are net buyers of maize according to a 1995 survey of Nairobi consumers (UN: CCA, 1998).

Maize is politically sensitive because of its importance to the poor, and because it is an important cash crop for large farm holders. More than 83 percent of marketed maize is sold by the largest 10 percent of farms (Jayne et al., 2000).

Agriculture is the lifeline of 80% of Kenya's poor who live in the rural areas, including farmers, workers and unemployed. Seventy percent of Kenya's
employment is in agriculture, consequently creating jobs and increasing income in that sector is vitally important and, if achieved, have an important direct effect on poverty (GOK, 2000).

- According to Mwega et al., (1988:35-39), SAPs in Kenya have adversely affected employment in the public sector, the largest source of employment in the country.

A major concern in this case is the ability of the liberalized grain marketing system to contain price instability within politically acceptable limits. Poor road and rail networks constrain the price-stabilizing potential of regional trade. A considerable part of the food price stability problem in the country is due to the high cost of transportation, which raises the price wedge between import and export prices and limit efforts to integrate regional markets through encouraging private cross-border trade.

Another issue affecting the internal/micro dimension is that measuring consumer response to food market reform in Kenya requires an understanding of the two basic types of maize meal in the country. For decades prior to the liberalization process, urban maize meal consumption was predominantly in the form of a refined sifted meal processed by a few large-scale urban roller milling firms. These registered milling firms were integrated into the state food marketing channel. Milling and retailing margins were fixed by the government based on millers' stated cost structure.
A second form of maize meal, whole or "posho" meal was consumed primarily by rural households. This whole meal was processed by small-scale hammer mills. Cross country studies indicate that unit processing margins for hammer-milled meal are typically less than one-third those of the refined roller-milled meal (Stewart, 1977; Bagachwa, 1992). Had other factors been constant, this would have given hammer millers a major cost advantage over the sifted millers yet the government subsidies were applied to sifted meal marketed through the official marketing channel, thereby reducing its price relative to whole meal.

5.2.4 Policy Alternatives

The NCPB case emphasizes not just the economic, but also the possible political ramifications of alternative modes of government intervention. This perspective calls for two familiar questions. First, what are the appropriate long term goals of policy, and what sorts of institution might best serve these goals? Second, is there a role for temporary policies and institutions that may smooth the path to such an envisaged set-up?

The political economy perspective offers important insight into both these questions. It suggests that policy outcomes arise effectively as political responses to the demands of people who are economically affected by those policies. In other words agricultural (and other) policies are determined by politics, rather than as a reaction to the advice of expert economists. The political economy perspective suggests that these policies exist not because they improve economic welfare, but primarily because the beneficiaries are more effective at exerting political pressure
than the losers (Gardner, 1983; Stigler 1971; Peltzman 1976). Thus the political economy paradigm can provide important insights into the demands that are likely to be made on politicians as they attempt to forge agricultural policies.

The intensity of political pressure exerted by agricultural interests in a developing country like Kenya may be greater than is manifested in the West because agriculture accounts for a greater share of employment, and because the uncertain direction of policy makes interest along the food chain less likely to assume that others will be effective in lobbying on their behalf. Moreover, in a fragile political environment, the pressure of urban consumers may be more keenly felt than pressures from rural constituency.

The importation of maize in the country has become a major controversial policy issue since the liberalization of the maize markets in 1994. Maize producers have continuously lobbied the government to limit maize importation by private traders and the NCPB, using the argument that imported maize is driving them out of business through unfair price competition. In response to producers’ pressure, the government has on several occasions raised the maize import duty as an anti-dumping measure.

Maize moved into urban areas by the NCPB was almost exclusively reserved for the registered large-scale sifted millers in the official marketing channel. This system ensured the registered millers of a protected urban market by suppressing the availability of grain for processing by non-registered millers. From the government’s standpoint, the existence of only a few regulated, large processing firms created a
convenient and easily managed system to link the state marketing board with
downstream processing and retailing activities and supply the urban population with
staple food at prices easily controlled by the state. Subsidization of the NCPB’s
trading account was the vehicle for maintaining low sifted meal prices. This market
should be open to competition.

The question of strategic grain reserves, which is used to justify the existence
of NCPB, could be addressed by an alternative policy. This study recommends
contracting out to private sector and allowing the sector to use the value of grain
under their bonded warehouses as security to borrow funds for their operation.

5.2.5 Practitioner Privatization Model (PPM) versus Government Decision

As the NCPB reform process continues to be political football between
government and donors, the PPM recommends that the institution be kept public as a
short term measure. The government however intends to retain it with restructuring as
the solution (GOK 2005). This points to the importance of a stable stance by donors
in managing the politics of reform. Donor credibility with government and the public
is important in sustaining the implementation of reforms. The critical question is
whether methods can be found to harness the state’s development potential in
marketing while controlling the predatory interventions that have in the past bedeviled
marketing policies.

This case according to the model serves as a good example of an industry with
a high level of social significance, which due to poor operational inefficiencies, must
be continually subsidized in order to ensure its survival. Even if it is privatized, this
type of enterprise will be a burden to the government continuously. Consequently, in this case, the decision for this type of industries is to "keep public" and under government control while alternative policies and regulations are put in place to ensure food security.

Much of the uncertainty over market reform within government arose from the concern that sifted maize meal prices would no longer be controllable in an unregulated market which could adversely affect household food security especially in drought years (Pinckney 1988). Moreover, many studies had contributed to the widespread perception that the elimination of food subsidies undertaken as part of structural adjustment had often hurt poor consumers and exacerbated their access to food (Stewart, 1991). In spite of these concerns and under pressure from international lenders, the Government of Kenya in December 1993 deregulated maize meal prices and eliminated the direct subsidy on maize sold to registered millers. As a result, sifted maize meal prices soared 53% within one month (Jayne and Argwings-Kodhek, 1997). After the initial increase and contrary to initial concerns, the price of both sifted and whole meal declined substantially in subsequent years.

5.2.6 Implications

It is difficult to envisage a wholesale reintroduction of marketing controls, but pressures for subsidies and price support have emerged and will continue to do so if the new system fails to adequately buffer producers and low-income consumers against severe production and price shocks. Without key public sector investment that reduces the cost and volatility of private trade, the sustainability of the reforms may
be jeopardized by calls for the re-imposition of state food purchasing and price controls. And the private sector’s commitment to invest in the new system is naturally sensitive to the risk of policy reversals and the re-imposition of controls. The current situation in the country is therefore one in which marketing policy has moved only recently to a fundamentally new stance, whose longer-run implications remain to be tested. At the heart of the problem is the level of price variability that may be expected under the new system, how the problems that this poses can be accommodated, and what will happen to marketing board, which now is envisaged as playing a limited price supporting role, but where the old processes of government price setting have remained largely intact.

The benefit to low-income consumers and rural grain-deficit areas from reliable access to grain has been enormous. Grain-deficit areas are where local supply is below quantity demanded. Research has indicated that the maize market reforms have reduced expenditures on maize meal by roughly US$ 10 million per year by Nairobi consumers alone, by raising their access to grain from millers with less expensive and more nutritious hammer-milled whole meal (Argwings-Kodhek and Jayne 1997). Furthermore, studies have shown that the subsidies on sifted maize meal in urban Kenya were disproportionately captured by the more well-off strata of the urban population, and that they served to entrench a non-competitive market structure that has inhibited the development of a lower-cost informal marketing system (Argwings-Kodhek and Jayne 1997).
The issue of timing and sequencing of market reforms is not confined to Kenya. It has been reported in other sub-Saharan African countries such as Malawi and Tanzania (Kherallah and Govindan, 1999; Booth, 1991). The experience from these studies and others (FAO, 1993) indicates that before reducing government operations in agricultural markets, measures to decontrol all prices and promote private sector participation should be in place.

5.3 The Case of Kenya Co-operative Creameries

"We made a lot of profit because milk is a profitable business and the market is wide," the chairman said as he announced that although the New KCC was for now fully government-owned, it would be privatized soon, after its operations were streamlined. He told farmers to be ready to buy shares."


5.3.1 Historical Background

The dairy sector has undergone phenomenal changes since the introduction of exotic breeds in Kenya in 1920s. The industry accounts for 25 to 35% of the agricultural Gross Domestic Product (MoA, 1995). Through time, smallholder farmers have gradually increased their participation in marketed milk production. Smallholder farms average two hectares and contributes about 80% of marketed milk production (MoA 1997). Smallholder farmers are therefore those farmers who own
this small plot of land and carry out what is referred to as subsistence farming which is mostly mixed farming.

Socioeconomic factors, demographic variables, infrastructure, farming practices are among the important factors affecting dairy production. There is considerable potential for increased productivity, increased employment and income generation in the dairy sector if commercialization is intensified through appropriate technologies, improved management and appropriate policy.

Procurement of milk has mainly been through dairy cooperatives especially for smallholders (MoA, 1999). Dairy processing has tended to develop simultaneously with production through the Kenya Co-operative Creameries (KCC). Until 1992, KCC was a monopoly with a countrywide network of 11 processing plants and 11 cooling centers with 26 sales depots.

Since the mid 1980s, the government has instituted several policy reforms and strategies in the dairy sector aimed at attaining sustainability and a proper balance in investments and provision of services between the public sector, the private sector and beneficiaries (MoA 1999). Some of these policy changes include: decontrolling of feed prices in 1989; milk price deregulation and liberalization of the sector in 1992; and reviewing of various legal and regulatory framework.

Co-operatives, as units for collective action, are legally operated under the co-operative Act (CAP 390, Laws of Kenya). They were encouraged to assist farmers to acquire credit, inputs and sell agricultural surpluses due to economies of scale embedded in bulk purchases and sales. Dairy co-operatives account for 34% of all co-
operatives (MoA, 1999). Dairy co-operatives have significantly contributed to the development of the smallholder dairy through milk marketing and provision of other services at relatively lower cost (Owing et al. 1998). The share of milk supply by dairy co-operatives reached its peak in 1987, accounting for 76% of KCC milk intake.

In the 1990s, performance of many Cooperatives had declined considerably due to political wrangles, management problems and stakeholder conflicts. These and other related governance problems calls for a need to improve the management of co-operative in the collective interest of sectoral development.

5.3.1.1 Milk Marketing

Milk Marketing has been regulated for a long time through the Dairy Industry Act (CAP 336, Laws of Kenya). Under the Act, the Kenya Co-operative Creameries (KCC) had the monopoly of processing and marketing of milk, especially in urban areas. KCC was also a buyer of last resort, guarantor of strategic milk reserves, and it benefited from direct government funding and external loans. Private sector participation in processing and marketing in the formal market was limited and in many cases, officially regulated by the Kenya Diary Board (KDB).

5.3.2 External / Macro Dimension

An enterprise with a high degree of social significance, possessing a high level of operational efficiency as well as a high external dimension, the model recommends that it be placed under quadrant IV of the Policy Matrix-Figure 3. Even if this type of enterprise is operationally efficient, because of its high social significance, if
privatization fails, it can cause serious social problems including massive unemployment. Consequently we must be very cautious when privatizing this type of enterprise. Dairy cooperatives, which have been operating efficiently, were vertically integrated via a marketing system operated by Kenya Cooperative Creameries (KCC). For many years KCC also operated efficiently and together serves as a good example of an enterprise which exhibited characteristics that falls under the fourth quadrant. KCC was privatized using a Big Bang approach in 2000, and a policy reversal effected in 2003 with the objective of using Gradual approach.

Public policy has been successful in promoting dairy development in Kenya. The integration of grade dairy cattle into the smallholder sub-sector can be attributed to support by government policies and support activities, including the provision of veterinary services and infrastructure development. This was more pronounced soon after independence. The KCC benefited from direct public funding and government guaranteed external loans. The donors have also contributed through specific programs and projects. Impact of donor and technical assistance has been phenomenal in building the dairy sector. Various organizations including the World Bank, Danish International Development (DANIDA), government of Finland (FINIDA), the Netherlands, United Kingdom, Swedish International Development (SIDA) and FAO have all contributed to the dairy sector (Omiti, 1997).

5.3.3 Internal / Micro Dimension

Kenya has a unique smallholder dairy system, which is the most developed in sub-Saharan Africa with an estimated dairy herd of 3 million head. Most the
smallholder dairy farms are concentrated in the crop–dairy systems producing about 60% of total milk production and contribute over 80% of the marketed output (Omiti, 2000). There are more than 5600 registered co-operatives in Kenya with a total membership of over 2.5 million. Dairy co-operatives account for 34% of all co-operatives (Omiti 1999). They have contributed significantly to the development of smallholder dairying through milk marketing and provision of other services at relatively low costs (Owango et al. 1998).

The ability of dairy enterprises to earn regular income and to contribute to the household diet on a daily basis throughout the year is an advantage over other farm enterprises. This is a pointer as to why dairy is favored as a cash crop for most farm households in Kenya even where other cash crops do equally well. Dairy production also creates employment for the rural communities at the farm level and off-farm employment to informal milk traders, co-operatives and others dealing with milk marketing. Recent studies indicated that labor for dairy production activities was provided mainly by the family but 60% of households were found to hire labor, with 20% retaining permanent labor throughout the year (Muriuki, 2000).

In principle, dairy cooperatives serve to reduce transaction costs facing individual producers through pooling risk, lowering unit collection costs, making inputs available, and enhancing bargaining power. For processors, cooperatives may lower raw milk acquisition (search) costs and make milk supplies more reliable. Raw milk from cooperatives members is transported (usually by the farmer or a farm household member) to nearby collection points. Milk is then delivered by the
cooperatives to private buyers or collection center or plants belonging to the Kenya Cooperative Creameries (KCC). Transportation is a major bottleneck and the leading cost item for cooperatives. One multi-district survey in the early 1980s found transport costs to account for 70% of the total cooperative costs and more than 22% of the cooperative milk sales prices (Muriuki, 2000).

5.3.4 Policy Alternatives

Dairy production contributes significantly to general economic welfare in Kenya. Small scale farms are the backbone of the dairy industry, and consumption of milk and other dairy products is widespread. The two main activities of the dairy cooperatives are: collecting milk from farmers; and marketing to local customers and/or delivering surplus to the Kenya Cooperative Creameries (KCC).

Most dairy processing and marketing were controlled by the KCC, a large semi-private cooperative which, until the 1992 policy change, held an official monopoly on processed milk sales in urban areas. KCC handled 90 percent of all processed milk sales and had been a major buyer at the farm level. In contrast non-KCC dairies processed only 5 percent of all reported marketed milk (Sellen et al 1990). Nairobi City and its environs, which is the largest single market in the country, accounts for over 60 percent of the formally marketed milk whilst Coast Province and parts of Western Province are among the milk deficit areas in the country; that is, where local suppliers cannot fulfill local demand.

In May 1992, the Kenyan government announced the decontrol of dairy prices, and the lifting of the KCC monopoly on processed milk sales to urban areas. Raw
milk sales policy did not change. The policy change increased the activity of secondary processors and informal traders in the market. Within a few months of policy change several small private milk processors began supplying milk to the Nairobi area.

In this environment there are sound socioeconomic reasons for committing resources to the creation of a viable market framework instead of destruction of the state sector. Creating a new market for the dairy farmers might entail merely removing state barriers and allowing a private entrepreneur spirit to take over. As there are transaction and opportunity costs to both privatization of state enterprises and the creation of new enterprises, a developing country with limited resources might be faced with a tradeoff: doing what, when. Time is required for new enterprises to emerge while the old state enterprise continues to operate to avoid disruption of the market.

5.3.5 PPM Recommendation versus Government Decision

According to PPM model, an enterprise with a high degree of social significance, possessing a high level of operational efficiency, would be placed in quadrant IV—'gradual approach. Dairy cooperatives that have been operating efficiently were vertically integrated via a marketing system operated by Kenya Cooperative Creameries (KCC). Consequently, we must be very cautious when privatizing this type of enterprise. For many years KCC also operated efficiently and together serves as a good example of an enterprise that exhibited characteristics that falls under the fourth quadrant. KCC was privatized for political expediency using the
Big Bang approach in 2000 and a policy reversal effected in 2003, with the objective of employing a Gradual approach to its privatization. The private sector had no capacity to fill the vacuum created by the departure of KCC.

This case demonstrates clearly the practical applicability of the model and how the government could have avoided the disruption of the dairy industry by using a Big Bang approach where the model recommends a gradual approach.

5.3.6 Implications

This case of KCC provides compelling evidence on how markets have failed rural communities when the state retreats from provision of services or in support of a leading national enterprise. There was no adjustment in the existing institutional structure nor was there any allowance for new institutions to emerge. As a result, privatization led to the collapse of the rural markets and other businesses that were dependent on them. This is thus a case which requires application of a gradual approach in order to facilitate smooth transition to competitive market. Secondly, despite their overwhelming number, the small scale farmers did not have the political power to influence the government in the way the large scale maize farmers have done. In addition the dairy farmers have been concentrated in the region that did not support the ruling regime and hence the destruction of the institution that supported their livelihood.

With the opening of the market, the role of KCC will have to diminish and the ownership question has to be settled. To improve dairy marketing, it is recommended that developing and maintaining rural access roads and establishing collection centers
with cooling facilities will be necessary if the small scale farmers are to sustain their lead in the industry.

5.4 Telkom Kenya Limited

5.4.1 Historical Background

Telkom Kenya Limited is the fixed line public telephone service provider and the existing telephone capacity is distributed throughout the country with a majority in Nairobi and Mombasa. The company also provides internet services which have opened the country to electronic commerce and other data communications websites. Before the liberalization program of 1990s brought the telecommunication sector to the forefront of debates on economic performance, global competitiveness and technological development of the country, telecommunication was regarded more as a public utility than as an instrument of economic competitiveness. Monopoly characteristics and political considerations made it a natural preserve of the state, where the dissatisfaction of a middle-class customer base could be tolerated in lieu of providing social security to a large employee base of the telecom department.

With waiting list for a telephone growing rapidly, funding constraints made the fulfillment of the estimated latent and registered demand almost impossible (ROK, 1996). The current demand for fixed telephone lines is far from being met. Kenya has about 300,000 fixed telephone lines and according to Communication Commission of Kenya (CCK) there is a potential for an extra 170,000 (Daily Nation, 9/13/2006). Responsiveness to rural development components of the telephone
remained largely experimental, as did efforts for developing and applying complementary communications technologies such as data networking. Disguised unemployment, superfluous labor and low productivity were readily acceptable as Kenya's version of social security. Moreover, inefficiency could be tolerated as long as the corporation managed to keep basic tariffs low (ROK, 1996).

The Telkom structure could no longer be sustained in the new globalized and liberalized environment in the country. A variety of factors – both structural and ideological – combined to effect liberalization in the basic telecommunications sector. The macroeconomic liberalization process initiated in 1991 was the most obvious. With the reforms in the latter part of the 1980s, the perception of the crucial importance of a robust telecommunications infrastructure to growth in an increasingly globalized economy was becoming a reality. The 1992 liberalization program, the shift from a national frame of reference to a global one, and the inability of the corporation to fulfill the demands of a globalizing economy for advanced communications services precipitated this realization, making reform in the sector virtually inevitable. The other major bottleneck – that of access to capital resources - still remained. Since the government has been facing resource crunch and could not direct more investment into the telecom sector, some form of private participation was imperative, to provide funds for network expansion and to meet growing technological changes.

This study examines the conditions for success of private investment for telecom expansion in a developing country using Kenya as a case study. The study
contends that successfully achieving private investment in the telecom sector is crucially dependent on the political mechanisms of governance and the nature of the state involvement in the sector.

5.4.2 External / Macro Dimension

An enterprise with a high degree of social significance, possessing a low level of operational efficiency, would be placed in the first quadrant of the model. Telkom according to the model would fall under this category for the following reasons:

- As already noted, the multilateral agencies and donor community are very much involved in the implementation of privatization in Kenya. They have helped set up and finance the institutional structure for privatization and ensure that the process remains on track by attaching it to their overall conditionality.

- The World Bank's private sector lending arm International Finance Corporation has already handed the government its findings on the value of both Telkom. The report indicates that the government needs urgently to sell its shares in the mobile company, Safaricom, to raise billions of shillings required to resuscitate the ailing Telkom ready for privatization as planned in April 2007. Reports indicate that the government must raise Sh27 billion to modernize the parastatal and finance retrenchment of nearly 11,000 staff to reduce the expenses from a bloated workforce (Daily Nation, 10/21/2006)

- The 1992 liberalization program, the shift from a national frame of reference to a global one, and the inability of the corporation to fulfill the demands of a
globalizing economy for advanced communications services has made reform in the sector virtually inevitable.

The experience of implementing the telecom liberalization process in Kenya indicates a problem of institutional change associated with the transformation of development strategies from a state-controlled to a market-led growth process.

5.4.3 Internal / Micro Dimension

Telecommunications has been regarded more as a public utility than as an instrument of economic competitiveness and this has contributed to its inefficiency. An extremely low level of telecommunications penetration in developing countries (evidenced for example by the discrepancy between developed and developing countries on a host of telecom indicators, Mansell and Wehn (1998)) shows that investing in telecom network expansion is crucial in order for developing countries to meaningfully take advantage of the global information economy. Burdened with inefficient management and budgetary and fiscal constraint, the corporation has been unable to deal with the needs of technological advances, or make investments for large-scale infrastructure.

Potential Telkom subscribers have grown used to waiting for several years before getting a line and this has put it on a collision course with market regulator, Communications Commission of Kenya (CCK) for failing to fulfill its license obligations. According to the license, Telkom was required to connect 25,000 new subscribers in 1999/2000. Many have had to part with bribes of as much as $250. Others found shortcuts by bribing postal staff and getting temporary lines they do not
pay for. Currently, many are now opting for cell phones (Africa Business, May 2002). According to the regulator, the fixed-line monopoly only managed 17,070 new subscribers in 1999/2000. Over 2000/2001, the license gave the firm a target of 60,000 new subscribers, but it only managed to connect 12,203 lines in that period. Telkom Kenya is also in breach of its license obligations with respect to pay-phone connections. It was expected to connect 5,000 new pay-phones for the year 2000/01. It only managed 66 (Africa Business, May 2002).

Telkom’s record contrasts sharply with the private sector-dominated mobile telephone operators, which have managed to attract a combined figure of 700,000 subscribers in less than two years. Safaricom Limited, which under the management of Telkom had a mere 9,000 subscribers, managed to connect more than 390,000 lines in 18 months – while its rival Kencell connected close to 300,000 lines over the same period. With the market having a disproportionately higher number of consumers on the cellular phone system, the net traffic flow is now acutely skewed in favor of the cellular operators because the propensity is for Telkom’s 300,000 consumers to seek the 700,000 people in the mobile system (Daily Nation, 3 Jan. 2006)

5.4.4 Policy Alternatives

The experience of implementing the telecom liberalization process in Kenya indicates a problem of institutional change associated with the transformation of development strategies from state-controlled to a market-led growth process. For infrastructural sectors such as telecom, investment is sunk, with long-term amortization and realization of returns over an extended period. This both provides
political actors the possibility of discretionary expropriation of the telecom firm’s assets, and necessitates mechanisms to guard against such expropriation.

The twin problem of privatization necessitates a regulatory structure that provides credible commitment —that is commitment against the exercise of arbitrary discretion and commitment against changes in the regulatory environment. When private capital is introduced along with the introduction of competition, this problem extends to ensuring that the incumbent monopoly, whether public or private, does not attempt to forestall competition by creating obstacles for new entrants (Levy and Spiller, 1996).

5.4.5 PPM Recommendation versus Government Decision

The PPM model has puts this SOE in the first quadrant where the policy recommendation is to ‘keep public.’ Telecommunication is essential for development and many parts of the country in Kenya are a long way from getting mobile phone facilities. Despite its outdated technology, Telkom still dominate the telecommunication industry in Kenya. Due to its inefficiency the government would need to maintain it until alternative technology reaches an acceptable threshold particularly in the rural areas where over 70% of the population lives. The government action coincides with the model recommendation.

5.4.6 Implications

The overall objective of information and telecommunication sector is to optimize its contribution to the development of the economy and poverty reduction by
ensuring the availability of efficient and affordable services throughout the economy. An attempt to sell 49 percent of Telkom to Mount Kenya Consortium failed, paralyzing the process for years. After two years of negotiations under the supervision of an experienced American merchant bank, Schroeder Salomon Smith Barney (SSBB), the Kenyan government called off the deal on November 2001 with winning bidder Mount Kenya Consortium on the grounds that it was too low (Africa Business, May 2002). A major problem in implementing privatization of Telkom relates to the restriction of tenders and the right of the government to disqualify candidates through notification from the senior officials of the Ministry of Communications, thus halting the privatization process at any moment. When the number of competitors is restricted, the price falls sharply. The government seems to have forgotten that, given the development of advanced communication technologies, Telkom can no longer be considered the ‘jewel in the crown.’

5.5 The Case of Kenya Airways

5.5.1 Historical Background

Kenya Airways is the national airline of the Republic of Kenya. The airline offers scheduled services to 28 destinations around the world and within Kenya. Kenya Airways traces its history back to 1946 with the formation of East African Airways Corporation (EAA). Initially, EAA had a good reputation for service and reliability. With the formation of the East African Community EAA passed into the joint ownership of the governments of Kenya, Tanzania and Uganda. Shortly after the
collapse of the East African Community in 1976, EAA was placed in liquidation.

Kenya Airways was incorporated in January 1977 as a company wholly owned by the Government of Kenya to be the national flag carrier of Kenya and acquired some of the assets and staff of EAA.

Over the years, however, there was a gradual deterioration in financial and operating performance which led to a decline in the airline's reputation. The Company experienced significant financial losses over the first 16 years of its existence, thus placing a heavy burden on the Government (KA, 1996). This was not unique to Kenya Airways. International aviation had become increasingly competitive as evidenced by the increase in alliances and partnership and yield pressure.

In 1992 the government announced its intention to privatize Kenya Airways. The key objectives of implementing privatization were:

- To ensure the continued operation of Kenya Airways as the national airline of Kenya
- To transfer the majority of Kenya Airways' ownership to the private sector
- To ensure that a proportion of the Company's shares were transferred to its employees.
- To allow Kenya Airways to build on its recent accomplishment of improved operating performance and profitability with support from private sector capital.

The implementation of privatization began in early 1994 with the appointment of a Privatization Committee comprising members of the board, Government and
professional advisers. International Finance Corporation (IFC), the investment banking arm of the World Bank, was appointed as principal adviser. One of the key tasks of the Committee was to ensure the accountability and transparency of the privatization process.

The re-structuring of the airline’s balance sheet was the first step in reducing the Company’s dependence on the Government. The reduction of Government involvement in the business continued with the invitation to international airlines to purchase a significant stake in Kenya Airways. This process was carried out in the later part of 1995 and led to the eventual participation of KLM through the Shareholders Agreement (KA 1996). The table below depicts the ownership change of KA:

Table 5: Kenya Airways Change of Ownership

<table>
<thead>
<tr>
<th>Shares held by</th>
<th>Percentage as at June 3, 1996</th>
</tr>
</thead>
<tbody>
<tr>
<td>Government of Kenya</td>
<td>23</td>
</tr>
<tr>
<td>KLM</td>
<td>26</td>
</tr>
<tr>
<td>ESOP*, provident fund and employees</td>
<td>3</td>
</tr>
<tr>
<td>Kenya Public</td>
<td>20</td>
</tr>
<tr>
<td>Kenya institutional investors</td>
<td>14</td>
</tr>
<tr>
<td>International Institutional investors</td>
<td>14</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

*ESOP- Employee share ownership plan

Kenya Airways moved from 100% government ownership to 23%. The initial public offering was oversubscribed by 94% by local investors while the foreign offer was oversubscribed by 12%. Over 113,000 Kenyans applied for the shares and 78,000
received the minimum allocation. Kenya Airways became the largest publicly quoted company on the Nairobi Stock Exchange and the second largest privatization to date in sub-Saharan Africa (KA 1996). The result of restructuring was a reduction in after tax losses by 62% by 1993. The airline registered a gross profit of Kshs 237 million from a previous gross loss of Kshs 53 million in 1992.

5.5.2 External / Macro Dimension

An enterprise with a low degree of social significance, possessing a high level of operational efficiency, would be placed in the third quadrant. Because of high operational efficiencies, this enterprise has the potential to successfully compete in a market economy. However, because of low social significance, even if privatization failed, social hiccup or repercussion will be minimized. Therefore, the model suggests the market approach as the appropriate decision for this type of enterprise. An example of a successful implementation of the market approach is given by the privatization of Kenya’s flag carrier- Kenya Airways. The privatization has been referred to as the largest single offer to date at the Nairobi Stock Exchange. The sale proceeds were in excess of KShs. 4 billion in cash (Oyieke, 2002).

During the late 1980s the Company acquires a substantial part of its fleet of aircraft. Most of these were purchased through foreign loans that were guaranteed by the government. Under arrangement agreed in Paris in January 1994 between the government and a number of donor countries (the “Paris Club”) certain debts of the government were rescheduled, including the debts of parastatals for which the government was responsible under guarantees it had issued to creditors. The financing
of Kenya Airways’ purchase of two A310s and three Fokker 50s in the late 1980s was included in the re-scheduling (O’Brien and Ryan, 1999). Both the Kenya Airways and the government had defaulted on repayments under the loan and guaranteed arrangements for these aircrafts partly as a result of the devaluation of the Kenya Shilling and because of the recession in the world airline industry in the early 1990s.

The Paris Club agreed to re-schedule some of the government’s debt and the creditors agreed to release Kenya Airways from its obligation to them for arrears on its loans incurred up to 31 December 1993 in return for the government assuming responsibility as primary debtor for an amount in foreign currencies equivalent to Kenya Shilling 4.3 billion in place of its former role as guarantor. The debt restructuring was completed in mid-1995 when the government completed a number of agreements with the lenders by which Kenya Airways was released from its obligations. The government converted the assumed debt into equity (ROK 1996). This is a good example where external stakeholders have had a positive result.

5.5.3 Internal / Micro Dimension

Airlines typically operate with high levels of fixed costs and profits, and are thus sensitive to small shifts in revenue. Revenue is driven by the interaction of yields and load factors. Excess capacity will tend to depress yields and load factors, whereas capacity shortage will tend to inflate them. The air passenger market in Kenya is estimated to comprise over two million international and domestic journeys per annum and the market depends heavily on tourist and business travelers attracted by the government’s liberalization program. Kenya Airways faces competition from
other local airlines in the Kenyan market, but remains the dominant provider of domestic scheduled air transport.

To stem the financial losses, a new board of directors was appointed by the government in April 1991, and given the mandate to commercialize the airline and prepare it for eventual privatization. In 1992, the board commissioned a consulting firm to conduct a thorough review of the airline and make recommendation on ways to improve the company’s performance. In order to implement the recommendation, KA entered into a service agreement and as a result a new management team was appointed and empowered to implement the recommendations. As a result of the changes made, Kenya Airways’ financial and operational performance improved and now enjoys a growing reputation as a quality airline. The turn-round is confirmed by the alliance concluded with KLM Royal Dutch Airlines, which purchased 26% of the shares for a price of US$ 26 million cash (ROA 1996). The exchequer ceased subsidizing Kenya Airways from 1994. It began paying taxes from 1996.

5.4.4 Policy Alternatives

The success of implementing privatization has been seriously questioned at both the policy and the general public level. Privatization has come to be wrongly associated with donor conditionality. The experience of Kenya Airways’ privatization is important for policy makers and implementers in Kenya. This case demonstrates one way in which the government can spur economic growth by freeing itself from subsidizing non-strategic parastatals and concentrating on creating the right economic/political environment for efficient and effective use of resources.
Privatization in Kenya has been undertaken with caution and fear: fear the loss of government control, fear of the negative effects on social dimensions of adjustment. Such fears act as impediments to policy makers and implementers.

5.5.5 PPM Recommendation versus Government Decision

This is a good example where a good restructuring strategy led to improved operational efficiency and culminated in public private partnership that employed a combination of direct sale of designated shares and an institutional investor. The case would fit in quadrant III; that is, the ‘market approach’ of the model. The government decision was the right decision although it had to absorb a huge debt to attract private partnership.

5.5.6 Implications

This case shows that there are clear gains from successful implementation of privatization, suggesting that Kenya can benefit greatly from privatization of the commercially oriented SOEs. The case points to the essential preconditions for success which include: transparency of the process and method, credibility of the supervising body, the will to privatize, a clear timetable and adherence to it. It is evident that correctly done, the micro and macro level benefits of implementing privatization would be achieved.
5.6 Kenya National Transport Company (Kenatco)

5.6.1 Historical Background

Kenatco came into the public sector in a rescue operation around 1966. Prior to its rescue by the government, Kenatco was a ‘large and confused cooperative transport company founded in 1964, in which some prominent people had a stake’ (Leys, 1975: 161). The company had two lines of business: goods transport via trucks and taxis. The trucks business was on international trade within the East African region. As conditions became more difficult during the seventies this business became less viable.

Kenatco’s precarious financial condition in the years immediately prior to being placed under receivership in December 1983 was greatly weakened by a poorly implemented policy on security escorts for transit cargo in the Northern Corridor Transport System. In 1981 Kenya agreed with Uganda, Rwanda, Burundi, Zaire (now DR Congo), and the European Economic Commission (EEC) that greater security was needed and each member state was to provide security escort services for transit goods. Normally such duty would fall under the police jurisdiction. The decision was taken fairly abruptly, so that there was little time for planning. Since Kenatco had suitable escort vans, it provided the transport and traveling allowances for the police officers who were to escort the transit goods. No provisions were made for compensating Kenatco for providing these police functions, which they provided not only for their traffic, but also for other transporters.
By May 1983, the amount outstanding to Kenatco for escort services was Kshs. 12.4 million, an amount which was equal to nearly one-third of its net assets. At that time Kenatco was living on an overdraft on which it was paying 16 percent interest. Kenatco decline was hastened by this policy, for which it can hardly be held responsible. Firms operating in competitive environment are unable to bear such sudden demands when no provision is made for their finance. Eventually Kenatco was put under receivership in December 1983 and subsequently sold (ICDC, 1985/86 and 1986/87).

5.6.2 External / Macro Dimension

In decision-making theory, choice opportunity where an enterprise with a low degree of social significance, possessing a low level of operational efficiency, would fall into the second quadrant and provide the prerequisite conditions for a rational decision-making process. Simon (1960) called decision of this type ‘programmed decisions.’ This enterprise exhibits both a low level of the External/Macro and Internal/Micro Dimension evaluation criteria, and therefore falls into the least favorable quadrant of the Practitioner Privatization Model. Due to its inability to compete, this enterprise would most likely be forced out of the marketplace immediately if placed in a market driven economy.

In addition, Kenatco’s had to provide security escort services for transit goods of the Northern Corridor member states. A decision which was not in favor of its commercial operation
5.6.3 Internal / Micro Dimensions

A study by Grosh (1991) on Public Enterprise in Kenya points out that most of Kenatco management was replaced in several occasions. Internal controls were not observed to the extent that "nobody knew who was doing what job, what vehicles were available and what work was in progress" (p140). The treasury staff noted that "Kenatco's management lacked the most important management tools for commercial enterprises" (p141). It was surprising that the government continued to subsidize the operation of this company.

The relatively low social significance of the enterprise does not justify government subsidies to ensure its survival. Maintaining this type of industry, which is very inefficient and bear little social significance will eventfully drain the nation's wealth and will be serious burden to the whole society. This is the case where classical comparative advantage should be employed. The goods produced by this inefficient domestic industry must be replaced by the imported product under globalized world economy. Therefore, the model recommends this type of enterprises to be dissolved or let die option.

5.6.4 Policy Alternatives

The private sector was already well established in this industry even at the early stages of the country's independence. The government could have provided the regulatory framework for fair competition within the sector and also provide improved security and road network for the transport sector to expand.
5.6.5 PPM Recommendation versus Government Decision

This enterprise exhibits both a low level of the external/macro and internal/micro dimension of the evaluation criteria, and therefore falls into the least favorable quadrant of the Practitioner Privatization Model. Due to its inability to compete, this enterprise would most likely be forced out of the marketplace immediately if placed in a market driven economy. The relatively low social significance of the enterprise does not justify government subsidies to ensure its survival. Maintaining this type of industry, which is very inefficient and bears little social significance, will eventually drain the nation's wealth and will be serious burden to the whole society. This is the case where classical comparative advantage should be employed. The goods produced by this inefficient domestic industry must be replaced by the imported product under globalized world economy. Therefore, the model recommends this type of enterprises to be dissolved or ‘let die’ option. This is the option that the government eventually took this gives support to the model.

5.6.6 Implications

Kenya National Transport Company (Kenatco) is an example that fits into this quadrant. The company operated in a competitive environment. It was not essential for government to own such a firm and, throughout its life, Kenatco’s persistent problems raised the question of whether it was really desirable for the government to own firms in competitive industry. One of the defining features of a competitive industry is that their prices are driven down to long-run average costs. There is no
margin from which to finance socially mandated, non-commercially oriented activities. Yet the government did not refrain from mandating such activities.

The government should recognize the limitations imposed on it as a shareholder by the competitiveness of the markets and avoid imposing non-commercially oriented activities to firms operating in a competitive environment.

5.7 Summary Application of the Model

The table below summarizes the cases discussed and offers a quick overview of the various policy decisions that are open to further research.

Table 6: Summary Table of Cases in the Study

<table>
<thead>
<tr>
<th>Case</th>
<th>External */macro</th>
<th>Internal/ micro</th>
<th>Policy Category</th>
<th>Implication</th>
</tr>
</thead>
<tbody>
<tr>
<td>NCPB</td>
<td>High</td>
<td>Low</td>
<td>Keep Public</td>
<td>Short-term solution/long term solution-allow private sector to handle security stocks</td>
</tr>
<tr>
<td>KCC</td>
<td>High</td>
<td>High</td>
<td>Gradual approach</td>
<td>Provide infrastructure and credit facilities as incentives</td>
</tr>
<tr>
<td>Telkom</td>
<td>High</td>
<td>Low</td>
<td>Keep public</td>
<td>Short term solution</td>
</tr>
<tr>
<td>Kenya Airways</td>
<td>Low</td>
<td>High</td>
<td>Market approach</td>
<td>Set a precedent for large SOE</td>
</tr>
<tr>
<td>Kenatco</td>
<td>Low</td>
<td>Low</td>
<td>Let die</td>
<td>Provide necessary infrastructure for private sector to thrive</td>
</tr>
</tbody>
</table>

* The 'external' includes the international stakeholders.
CHAPTER VI

CONCLUSION AND FURTHER RESEARCH

Understanding the nature and role of macro-micro dimensions and factors in the implementation of the national privatization reform program is important to policy makers and the public manager. The study shows that despite the worldwide policy convergence toward privatization, Kenya has been slow in implementation. The political bias has influenced the pace by shaping the choice of institutions and selling conditions. By focusing on implementation, the study defines this influence in terms of the different dimensions that the public manager faces.

Finally, the importance of the selected SEOs for economic development and public satisfaction suggests the political salience of these industries. These are industries where the assets are relatively valuable for distributional gains among constituencies. Further research into other countries’ economic policies is necessary to assess the scope of the practitioner model in explaining preference formation for decision making.

Literature highlighting economic crisis as the primary catalyst of reform has also come under closer scrutiny as reforms have been implemented in a variety of economic conditions. As reforms have spread, our understanding of their determinants has also changed. This dissertation has examined those determinants and with illustrative examples examined the realization of privatization reform in a developing country.

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Kenya’s reliance on developmental policies resulted in an increasing role for the public sector such that by the early 1990s, the state-owned enterprise numbered 240. The impact of international influence had a strong influence explaining some of the increased speed with which Kenya implemented some privatization. While Kenya has had what has been characterized as an on-again, off-again relationship with the IMF and World Bank during the 1980s and early 1990s, these institutions suspended all funding between 1997 and 2001 and this was followed by other donors. Despite this the state weathered international pressure and economic difficulties, rhetorically supporting privatization but slow to withdraw from the economy.

This research highlights some avenues for future work. The varying impact of international influences demonstrated herein deserves further research. In addition, the findings regarding privatization’s effect on government spending highlight a significant area for further study. This dissertation has been premised on the need to disaggregate market reforms to fully understand their determinants. Privatization is but one element of far reaching neo-liberal economic reforms, the findings herein should be tested in other policy areas to examine the applicability of the practitioner model to the body of reforms.

The study has contributed to the economic reform literature by applying a situational analysis to the process of decision making for the sole purpose of implementing privatization. I have provided a unique analysis of the reform process itself. Secondly, by focusing on the determinant of implementing privatization reform, this dissertation adds to a growing body of literature that attempts to unravel the
myriad differences in market reform. This work complements the body of work on the political economy of market reforms that seeks to further elucidate the evolving global convergence around neo-liberal economic reforms.

The Kenyan case demonstrates the difficulties of implementing privatization in a relatively open yet fragmented political system with significant legacy of state interventionism. My central thesis is that the political, economic and institutional context and their mutual interactions are crucial in explaining the pace or success of implementing a privatization program. In the Kenyan setting, fragmented political system, characterized by authoritarian and patronage government, has been instrumental in the delays and setbacks experienced by the privatization program. For example, when the second president came to power in 1978, he adopted a populist approach to public affairs with the tendency of making major policy decisions in public political rallies without regard to existing laws and concerns (Wanyande, 2001). Consequently, most of the policies failed at implementation because modalities of how the policies would operate were not worked out and often they contradicted the country's rules and regulations.

The conclusion of this study is that a country must design an SOE reform strategy that is compatible with its political and economic environment. SOE reform cannot take place in a vacuum. An SOE reform strategy must at once be both narrow and broad in scope: narrow in order to take into account the circumstances facing individual SOEs, and broad in order to provide for both public and private sector reform and at the same time have flexibility to adapt to political and economic
changes. In summary, the answer to SOE inefficiencies in a developing country like Kenya is not “privatization at any cost,” but rather “economic growth through broad SOE reform.”
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