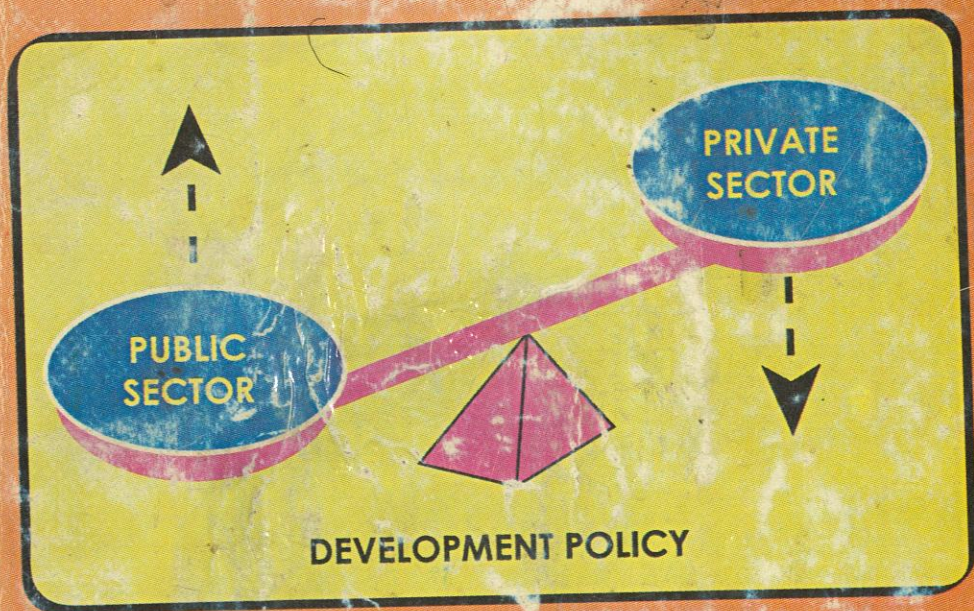


**HANDBOOK ON**

**PUBLIC - PRIVATE SECTOR  
RELATIONSHIP IN  
ECONOMIC DEVELOPMENT**

**SEARCH FOR EFFECTIVE BALANCE**



Estomih J. Nkya

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ON

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**SEARCH FOR EFFECTIVE BALANCE**

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Finally, the normal caveat is in order here. None of the above people, however, share responsibility for either the opinions or for any factual errors contained in this handbook. Full responsibility for errors remains with the author.

## PREFACE

This is a handbook on development policy. Rebalancing the public-private sector relationship in economic development is undertaken through development policy. The process of economic development and ideological paradigm shifts evident in 1980s and still unfolding led to economic and institutional reforms that necessitated rethinking the balance and relationship between the public and private sectors, in both less and more developed countries. Reforms in the public, financial and fiscal sectors and macroeconomic stabilization have necessitated changes in economic development policies that recognize the importance of the private sector in economic development and hence tilting the public-private sector relationship in favour of the private sector after several years of state-centred development. The private sector is now considered a critical driving force in economic development, and in Less Developed Countries, an important strategy for poverty reduction through recognition of the informal sector.

The purpose of this handbook is to analyse the changing relationship between the public and private sector in favour of the latter, as a strategic policy change for faster economic development and poverty alleviation. The analysis is based on review of relevant theories, public-private sector rebalancing experience in Tanzania, and illustrative empirical case studies from the author's research projects in Tanzania. Development policies are viewed as important instruments for changing the balance between the public and private sectors. The idea of writing the handbook emanated from a series of graduate seminars on development policy conducted at Mzumbe University in Tanzania between 1997 and 2005. Most of the material was discussed by graduate students and faculty colleagues and revisions were continuously made to reflect experiences and observations of the seminar participants and colleagues.

The overarching issues related to Public-Private Sector Relationship (PPSR) in Less Developed Countries include performance of the public sector, roles of the public sector in growth and development, indigenous private sector capacity, nature of private and public goods, globalization, direct foreign investment, safety nets for the poor, public-private partnership, privatization, new public management paradigm, non-governmental and community-based organizations and economic regulation. These issues are discussed in this handbook through theory and illustrative case studies.

The sub-title focuses the handbook on the need to search for an effective context-specific balance between the two sectors through appropriate policy and

institutional reforms. The balance being sought should be dynamic in terms of changing with times and evolving socio-economic circumstances at national and international levels. Effective balance refers to public-private sector relationship that would facilitate achievement of the public sector goals of accountable responsive delivery of public goods and the private sector goal of profit realization.

The handbook is structured into ten chapters followed by fifteen relevant case studies illustrating public-private sector relationship in various areas of development policy management. Each chapter is followed by review questions for training purposes. The first four chapters deal with theoretical background, perspectives and analytical frameworks that underlie public-private sector relationship. Chapters that follow deal with specific issues related to the public-private sector relationship.

Chapter One describes and discusses conceptual framework for the public-private sector relationship and how the nature and theory of goods is deployed to rationalize the need to distinguish roles of public and private sectors.

Chapter Two presents the background and rationale that necessitated changing the balance between public and private sector relationship in Tanzania. It is argued that the ongoing rebalancing is a response to the economic crisis of the 1980s against the backdrop of world-wide economic paradigm and ideological shifts. The impact of the economic crisis is characterized by a model that depicts economic paradigm shifts that led to economic and institutional reforms. Generations of economic policy reforms are also characterized in this chapter.

Chapter Three is the most extensive. It reviews relevant extant theories, perspectives, rationale and strategies for rebalancing the public private sector relationship through "broad" privatization that includes not only outright sale of state-owned enterprises, but also public-private partnerships, contracting out, management contracts, leasing and deregulation.

In chapter Four the agency theory is deployed to compare public and private sector management and thereby raising important issues that distinguish public and private sector performance. The theoretical discussion examines the extent to which private sector management styles and notions could be applied to the public sector management.

Chapter Five discusses issues related to public-private sector relationship. The chapter presents the concepts, scope, frame of analysis, forms and characteristics

of the public-private partnership (PPP) as a strategy of rebalancing the public-private sector relationship.

Privatization policy and process in Tanzania are presented in Chapter Six as a major strategy for rebalancing public-private sector relationship. The focus is on institutional framework, process and outcome of privatization.

The issues of indigenous private sector and entrepreneurial capacity are analysed in Chapter Seven while political economy of rebalancing the public-private sector relationship is analysed in Chapter Eight, where globalization and related issues of Direct Foreign Investments (DFI) and Non-Governmental Organizations are discussed.

Chapter Nine discusses the intractable issue of economic regulation as the major remaining role of the public sector in an economy moving through a transition from state-centred to market-centred development. Chapter Ten concludes the handbook by linking the changing public-private sector relationship with paradigm changes in development management.

The appendices present synopses of case studies of public-private sector relationship in the form of public-private partnerships and other forms of broad privatization. The case studies are referred to in the relevant areas of the handbook text. Some of the case studies are followed by analytical questions for training purposes.

## Public-Private Sector Relationship and the Economic Theory of Goods

### The Setting

There is always a relationship between public and private sectors at all levels of economic systems: at international, national, and local levels. The public-private sector relationship may exist at various levels of relationship such as individual and public sector, group of individuals and public sector, private company and public sector, association of individuals and public sector, and civil society organizations and public sector. In other words, the private sector in this context has a wider meaning than merely private business sector.

The purpose of this chapter is to rationalize the public-private sector relationship in the context of the economic theory of goods. The central question is: what makes public sector public and private sector private? The criteria that distinguish public and private sectors are reviewed and it is recognized that public policies and their instruments are central in determining what socio-economic activities should be in either public or private realms. A typology of goods is presented and the nature of goods is analyzed to determine what goods should fall under either the public or private sectors. However, public policies may not necessarily follow the dictates of the nature of goods. Underlying economic ideology, strategic outlook and political economy have a significant role in determining which activities and goods fall under the public sector.

The main argument in this chapter is that, assuming away public policy and politics, and given an appropriate institutional framework, the respective size or weight of the two sectors in economic development could be determined by the nature of goods and services produced in the economy.

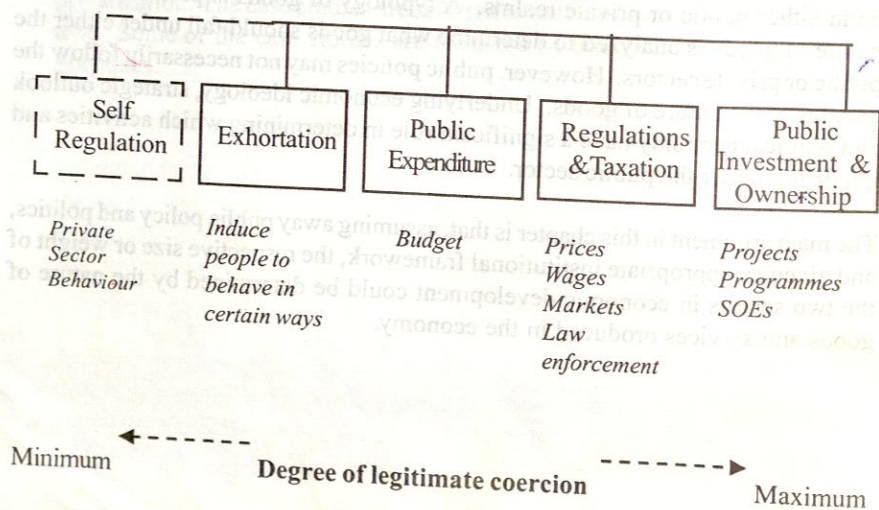
## Conceptual Framework for Public-Private Sector Relationship

This section presents various concepts and theories that justify public-private sector relationship in economic development. Specifically, the section deals with conceptual criteria that differentiate public and private sectors in economic terms. The criteria are:

- Ownership (state, private, joint, cooperative)
- Control (management contract, delegation of powers, joint control)
- Nature of the good or service (public or private)
- Motive or interest in production or consumption (profit, donation, charity, power, provision etc)
- Financing (public, private, joint, aid)
- Policy, legislation or decree, and their goals.

Another conceptual question is: what differentiates public policy from other policies? Policy is a standing decision and a guide to action. Source of policy, rather than impact, is what differentiates public from other policies. Figure 1.1 below presents major categories of instruments of a public policy.

Figure 1.1: Categories of Public Policy Instruments



Source: Doern and Phid (1983) in Pal L. (1987): *Public Policy Analysis*

## Economic Theory of Goods (Public vs Private Goods): Why Public Sector?

Goods and services in any economy could be classified into two major categories of public and private goods with two other intermediate categories, which depend on the degree of public and private nature of goods. Goods and services can be distinguished on the basis of two criteria - possibility of excludability in consumption and nature of use.

*Excludability entails* the possibility of excluding a particular individual from consumption or use of a good once it is supplied. Non-excludable means that it is impossible to exclude from the benefits those who have not contributed towards the cost of the goods. Non-contributors become *free riders* and producers will not find it worth producing the goods.

*Nature of use* connotes how a good is consumed. Rivalry in consumption means if one consumer gets good X another will not get it. Non-rivalry (or non-subtractibility) means that the benefit gained by one person from the service does not reduce the benefit other people can gain. This implies that the cost of providing the service to an extra person is zero and the market would not act efficiently in charging for the extension (Batley, 1994).

The following four types of goods are distinguished on the basis of the above criteria:

### *Pure private (or specific) goods*

Produced goods that are individually used or consumed such that some individuals can be excluded from consumption if they do not pay for the goods. They are also complete rivalries. The goods are exclusive since the person who owns them has the legal right to exclude others from benefiting from the goods. The allocation of specific goods (such as cars, houses, medical services, etc) should be through market prices determined by supply and demand.

### *Pure public (or collective) goods*

Produced goods that have a property of joint consumption or non-rivalness in consumption by several individuals. Benefit accrues to all individuals from the same good simultaneously. Consumption is also non-excludable, that is, it is impossible to exclude particular individuals from consumption. Examples of such goods are national defence, law enforcement, flood control, and street lighting. Providers and sellers cannot charge a price from users since the latter can consume it free of charge (*the free-rider problem*). Since a voluntary price cannot be

enforced on rational individuals, any price charged for the use of non-excludable public goods has to be *coercive*, such as taxes. It is therefore difficult to allocate collective goods on the basis of market prices since normal relationship between supply and demand does not operate in the public sector.

In general, public goods are those whose consumption cannot easily be denied to non-payers (non-excludable) and where consumption by one person does not prevent consumption by others (non-rival).

**Toll goods**

Produced goods that are subject to joint use or consumption (e.g. roads, bridges, etc) but individuals can be excluded from consumption if they do not pay for them. The goods are also subject to congestion or overcrowding, such as swimming pools.

**Common-Property goods**

These are natural resources, which are not produced, but subject to congestion, degradation and depletion. These are goods consumed individually and simultaneously and costly, though not impossible, to exclude an individual from consumption. Ostrom (1990) describes such goods as "scarce resources used in common, from which it is not feasible to exclude potential beneficiaries from using or consuming it, and for which each actor's use or consumption of it subtracts from its availability to others" (p.2). Users treat common-pool goods as free but in reality they are scarce. Examples of such goods are grazing fields, national parks and fishing grounds.

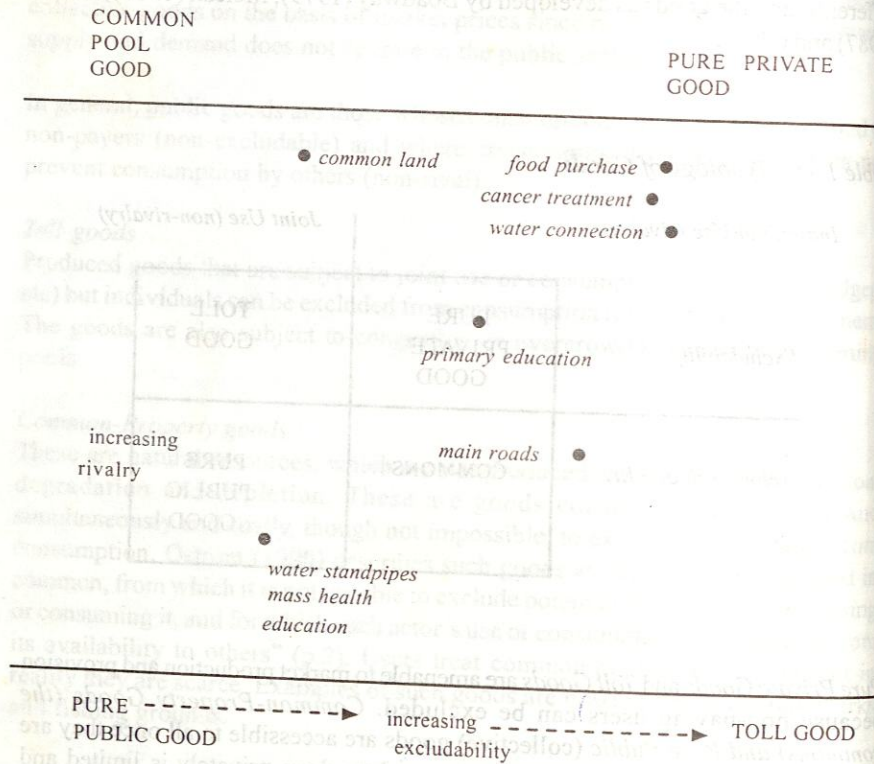
Table 1.1 below presents a typology of goods and services, and criteria for differentiating the goods as developed by Boadway (1979), Mclean (1987), Savas (1987) and others.

Table 1.1: Typology of Goods

	Individual Use (rivalry)	Joint Use (non-rivalry)
Excludability	PURE PRIVATE GOOD	TOLL GOOD
Non-excludability	COMMONS	PURE PUBLIC GOOD

Pure Private Goods and Toll Goods are amenable to market production and provision because non-paying users can be excluded. Common-Property Goods (the commons) and Pure Public (collective) goods are accessible to all once they are provided and hence market incentive to produce them privately is limited and hence leads to "market failure". They need public sector or public-private sector partnership to provide them. According to Batley (1994), concepts of public goods are scalar, interpreted subjectively, situation specific and likely to occur in mixed bundles. Figure 1.2 below presents Batley's classification and examples.

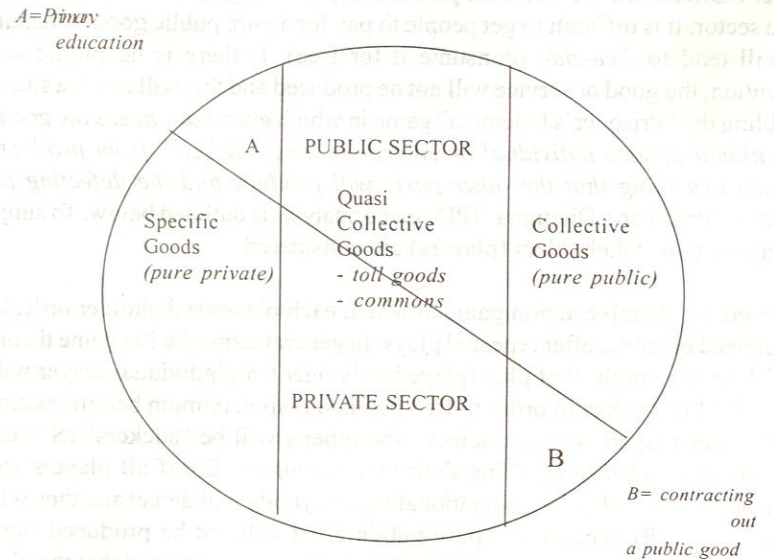
Figure 1.2: Classification of Goods



Source: Batley (1994) Figure 1; p7

Hinrichs and Taylor (1972) have provided a slightly different classification of goods. They have identified "Quasi-collective goods" as specific or private goods whose production has significant *spill over* effects for society. For example, although elementary education can be provided by private sector, the spill-overs are regarded as so important that the government produces great quantities at a cost affordable by all. In this regard, Bekerman (1989) characterizes "equity or merit good" as one in which there is a commitment in society to have the good accessible to all regardless of ability and willingness to pay and in regard to wider social benefits it engenders. Examples are public education and health. Contrasts between the production of these goods in the public and private sectors are illustrated in figure 1.3 below.

Figure 1.3: Classification of Goods



Source: Adapted from Hinrichs and Taylor (1972) in Dunn (1981, p241)

Procedures for estimating the value to producers and consumers of the three categories of goods differ. Profit maximization guides valuation in private goods in which opportunity cost of various decisions has to be made. *Opportunity cost* refers to the benefits sacrificed or foregone by investing resources to produce one product when another more profitable alternative could have been chosen.

We can apply the concept of opportunity cost in the public sector by viewing public programmes as investments in the production of goods that might have been made by the private sector. For example, if the government invests Shs 50 mln in the construction of a dam that will yield Shs 10 mln in net benefits to farmers, it must extract these investment resources from private citizens (through taxation) who could have invested the Shs 50 mln in the dam or elsewhere. If the private investment would have yielded Shs 25 mln in net benefits to private citizens, then the opportunity cost of building the dam is Shs 15 mln foregone, i.e. private benefits of 25 mln minus public benefits of 10 mln (Dunn, 1981).

### A Case for Public Sector - "Prisoner's Dilemma" Analysis

Prisoner's Dilemma arises from the problem of producing a pure public good by the private sector. It is difficult to get people to pay for a pure public good voluntarily; they will tend to *free-ride* (consume it for free). If there is no public sector intervention, the good or service will not be produced and this will result a situation resembling the "Prisoner's Dilemma" game in which *everybody needs the good but as a rational private individual or enterprise, one "defects" from production/provision expecting that the other party will produce and the defecting party free-rides*. "Prisoner's Dilemma" (PD) game analysis is outlined below. To simplify the analysis two stakeholders (players) are considered.

PD depicts a collective action game in which each player/stakeholder orders his/her preferred outcome after repeated plays. In general terms the PD game theorizes that with only a single shot play (played only once), an individual player will be "tempted" (T) to defect in order to free ride and reap maximum benefit assuming that the other players will not defect - the other/s will be "suckers" (S = easily deceived) and will lose by using their own resources. But if all players would behave on the basis of individual rationality, everybody will defect and they will all be "punished" (P) because the pure public good will not be produced (termed "Nash" equilibrium). In repeated (experience) plays it is expected that the players will recognize the need to cooperate rather than defect because that is the only way that the pure public good can be produced in which all players are "rewarded" (R); that is get benefits. This analysis, is symbolically depicted in Table 1.2 below.

Table 1. 2: Scheme of Pay-offs (Symbolically)

		YOU	
		Cooperate	Defect
I	Cooperate	R,R	S,T
	Defect	T,S	P,P

Table 1.3 below analyses numerically the Prisoner's Dilemma game. It is shown that based on individual rationality, the temptation (T) to defect expecting to free ride should carry the highest pay-off (let's say 3) to the defector and a zero (0) value to

the sucker(s). The second best should be *cooperation* in which the good is produced jointly and each player gets a pay-off which should, however, be less than 3 (let's say 2). If every player defects expecting to free ride, the good will not be produced and all players lose (P). The loss is not, however, as severe as when one becomes a sucker (0) because, psychologically, they are both losers. They are, however, both punished (P) by loss for defecting and the value of the pay-off should be between (2) and (0), let's say (1).

$$\begin{aligned} \text{Therefore: } T > R > P > S & \text{ but } 2R > T + S \\ 3 > 2 > 1 > 0 & \quad 4 > 3 + 0 \end{aligned}$$

That is, for society as a whole, and in repeated plays (experience), the reward (pay-off) from cooperation ( $2R = 4$ ) is better than the temptation to defect expecting the other will be a sucker ( $T + S = 3 + 0$ ). The entire scheme of pay-offs can be presented numerically as shown in table 1.3 below.

Table 1.3: Scheme of Pay-offs (Numerically)

		YOU		
		Cooperate	Defect	
I	Cooperate	2,2	0,3	1st digit is for 'I' scores 2nd digit is for 'Y' scores T = 3 R = 2 P = 1 S = 0
	Defect	3,0	1,1	

Analysis of pay-offs for each player and for all as a society is as shown below.

Action	(Individual Rationality)		(Collective Rationality)		
	Pay-off	Rank (I)	Rank (Y)	Society (I & Y) Pay-off	Rank
(a) I defect You cooperate	I = 3, Y = 0	i	iv	3	ii
(b) I cooperate You cooperate	I = 2, Y = 2	ii	ii	4	i
(c) I defect You defect	I = 1, Y = 1	iii	iii	2	iii
(d) I cooperate You defect	I = 0, Y = 3	iv	i	3	ii

Note that I would prefer action (a) because my pay-off is maximum (3). You should, however, prefer action (d) in which you have maximum pay-off (3).

In terms of society as a whole (I and You), however, action (b) in which we cooperate is the best because the maximum joint pay-off is (4). If we both defect the pay-off to society (both of us) is the minimum (2), which is called a “nash” equilibrium (McClean, 1987).

The main question which has pre-occupied social scientists for many years is how to get stakeholders to “cooperate” in order to realize the most effective solution (with total pay-off of 4) in a situation similar to the PD problem. That is, how to induce stakeholders to appreciate and prefer collective rationality for public goods.

Solutions that are practised include: taxation, public provisioning and public investment which create the public sector including the State-Owned Enterprises (SOEs), and hence the need for govt revenue and expenditure. Another solution is to get people to cooperate by showing them that it is in their best interest to do so; that is to get them exercise “collective rationality” instead of individual rationality. This is the arduous process of moving from the “Nash” equilibrium cell (P,P) with minimum total (societal) pay-off (2), to cell (R,R) with maximum total (societal) pay-off (4). The main technical problem of public goods is, therefore, the inability of the market to translate potential willingness to pay into revenues.

### Rationale for Studying Public-Private Sector Relationship

If there is always a relationship between private and public sector (think of all the relationships possible between the state and citizen), why study it at this particular time in Tanzania? The focus in this chapter is on economic relationship which deals with the following key issues:

- What types of economic relationship existed at different periods in the Tanzanian economic history? What was the nature (or balance) of the public-private sector relationship before and after economic liberalization? What circumstances necessitated change? What are the outcomes of the change? Is the economic situation improving as a result of “rebalancing” the public private sector relationship?
- A shift from state-centred development to market-centred development with the private sector taking the driving seat.
- Development of partnership between the public and private sectors in economic development involves restructuring (rebalancing) relationships between the public and the private sectors.
- Privatization of the state-owned enterprises, delivery of public services and decentralization of economic power from central to local-level institutions.

Why the shift from state-centred development to market-centred development?

- How to close the gap between the decreasing resources and the increasing needs.
- Economic crisis of the 1980s that signalled failure of the state-centred development approach. Deterioration of economic effectiveness and efficiency of the public sector owing to “overloading”. This was a ‘state failure’, unlike ‘market failure’ that justified state-centred development in the 1950s and 1960s.
- Intensified globalization of economic activities and transfer of ideas. Liberalization of labour and capital markets. Growth of technology as a determinant factor of economic growth, development and prosperity.
- Paradigm shift. A paradigm is a world view shared by a scholarly group working on or thinking about a particular topic or area of inquiry (e.g. neo-classical economics). The view affects their activity across the board including the questions which are asked, the information which is collected, the method of interpretation of the information, and policy recommendations.

## Policy Goals and Reforms in Public-Private Sector Restructuring

The shift of paradigm, public policy goals and the ongoing economic reforms engender several aspects that require effective public-private sector relationship as outlined in Table 1.4 below.

Table 1.4: Goals and Related Economic Reforms that Defined PPSR

GOALS	REFORMS
Fiscal Stability	<ul style="list-style-type: none"> <li>• Expenditure reduction</li> <li>• Privatization</li> <li>• Tax reform</li> </ul>
Managerial Efficiency	<ul style="list-style-type: none"> <li>• Decentralized management</li> <li>• Executive agencies</li> <li>• Quasi-markets</li> <li>• Corporate board of directors</li> <li>• Performance contracts</li> <li>• Contracting-out</li> </ul>
Capacity Building	<ul style="list-style-type: none"> <li>• Human resource development</li> <li>• Policy analysis and monitoring</li> <li>• Management of recurrent costs</li> <li>• Management of public investment</li> <li>• Pay reform</li> </ul>
Public Accountability	<ul style="list-style-type: none"> <li>• Citizens' Charters</li> <li>• Ombudsmen*</li> <li>• Service delivery surveys</li> <li>• Plural parliaments</li> <li>• Press freedom</li> <li>• Independent judiciary</li> <li>• Mass-based political parties</li> <li>• Civic action</li> </ul>

Source: Banguri, Y.(2000) "Public Sector Restructuring: The Institutional and Social Effects of Fiscal, Managerial and Capacity-Building Reforms", Occasional Paper No. 3, p8, UNRISD, Geneva.

\*Ombudsman is an official appointed by government to investigate on complaints of citizens against public authorities.

## Conclusion

The nature of goods was analyzed to determine what goods should fall under either the public or private sectors. Goods and services in any economy could be Source: Banguri, Y.(2000) "Public Sector Restructuring: The Institutional and Social Effects of Fiscal, Managerial and Capacity-Building Reforms", Occasional Paper No. 3, p8, UNRISD, Geneva.

classified into two major categories of public and private goods with two other intermediate categories, which depend on the degree of public and private nature of goods. Goods and services can be distinguished on the basis of two criteria - possibility of excludability in consumption and nature of use. However, public policies may not necessarily follow the dictates of the nature of goods. Underlying economic ideology, strategic outlook and political economy have a significant role in determining which activities and goods fall under the public sector.

The following chapter characterizes the 1980s economic crisis in Tanzania and the reforms that ensued as a strategic response aimed at tilting the public-private sector balance in favour of the private sector.

## Discussion Issues

1. Play a two-person Prisoner's Dilemma game as instructed below.
  - i. Agree on a public good, e.g. law and order in your room.
  - ii. Determine pay-off for each stance/position (both individual and collective).
  - iii. Prepare a pay-off matrix for each player.
  - iv. Rank the pay-off for each player.
  - v. Determine your individual best stance/position (individual rationality).
  - vi. Determine the best stance for both of you collectively (collective rationality) in repeated plays.
  - vii. What is the difference between the stances in (v) and (vi) above in terms of providing the good (consequence of each stance).
  - viii. What would you have to do in order to have the good provided (policy)?
2. What is the difference between the following types of goods:
  - a. Pure Private Goods and Toll Goods.
  - b. Pure Public Goods and Common Property Goods.
3. What is the importance and policy relevance of classifying goods into public and private goods?

4. In reference to the Hinrichs and Taylor Model (Fig.1.3)\*, in which area would you place the following goods and why?
  - a. Primary (basic) education
  - b. Garbage collection in urban areas
  - c. National defence
  - d. Law and order.
5. How could you use the concept of opportunity cost to justify the need for private sector production instead of the public sector?
6. What is the essence of the "Prisoner's Dilemma" and how could the dilemma be used to justify for public sector production?
7. What are the possible ways of going round the "Prisoner's Dilemma"?
8. What necessitated the shift from state-centred to market-centred development?
9. What is the essence and importance of PPPs?
10. What are the major challenges in PPPs?
11. How could you link the current economic policy reforms with "rebalancing" of the PPSRs?
12. In the context of the Economic Theory of Goods, to what extent could you justify privatization of SOEs and services in Tanzania? To what extent is the temporal (historical) factor significant? Should TANESCO be privatized?

\* See p.7

## Rebalancing Public-Private Sector Relationships in Tanzania: A Response to Economic Crisis

### The Setting

The changing balance between public and private sectors is driven by a convergence of changing socio-economic conditions, dictated by both domestic (national) and international forces. In Tanzania, for example, the ongoing rebalancing of public-private sector relationship in favour of the private sector is a response to the economic crisis of the 1980s against the background of world-wide economic paradigm and ideological shifts of the 1970s, after several years of state-centred development. The heavy dependence on the public sector as an engine of growth and development, and the subsequent persistent poor performance of the sector, precipitated the economic crisis.

The purpose of this chapter is to characterize the 1980s economic crisis in Tanzania and the reforms that ensued as a response to the crisis. The essence of the ongoing reforms is tilting the balance between the public and private sectors in favour of the latter within the context of the market-centred development paradigm driven by free market and economic efficiency. It is believed that economic growth is a necessary, though not sufficient, condition for development and poverty alleviation.

The central argument in the chapter is that, like in many other less developed economies, economic crisis in Tanzania provided the initial drive for changing the public-private sector relationship in favour of the private sector, against a background of the non-performing public sector.

### The Economic Crisis in Tanzania in the 1970s and 1980s

Rebalancing Public-Private Sector Relationships in Tanzania is a response to the economic crisis that engulfed the economy during the early years of 1980s. The economic crisis was characterized by significant declines in the major economic performance indicators. The average annual rate of real GDP declined from 5.1% during 1970-76 to 1.2% during 1980-85 while population was growing at about 3% per annum. The annual growth of the real per capita income declined from 2.5% during the 1965-70 period to

(minus) -1.5% during the 1980-85 period. Inflation also increased from an average annual rate of about 11% during the 1970-76 period to about 31% during the 1980-85 period. The overall budget deficit grew from 2% of GDP before 1976 to about 19% of GDP in 1979. The balance of external account deteriorated from a surplus of US\$131 million in 1977 to a deficit of US\$395 million in 1985 (URT, Economic Surveys, various years).

The rapid growth of the public enterprise sector and its poor performance contributed enormously to the crisis. While at independence in 1961 the state had majority shareholding in only three business enterprises, by 1966 the government had 100% shareholding in 43 enterprises and by 1979 a total of 380 state-owned enterprises had been established. By June 1990 Tanzania had 425 state-owned enterprises which accounted for about 24% of non-agricultural employment and 13% of Gross Domestic Product (URT, 1993b:3). While in 1965 the state-owned enterprises employed only 5% of the total labor force, in 1980 that proportion had reached 34% and that of the private sector fallen from 42% to 30% (World Bank, 1989:95 cited in Nkya, 1995).

Performance of the Tanzanian state-owned enterprises manifested a significant deterioration trend up to the 1990. They accounted for about 24% of non-agricultural employment but only 13% of GDP. Their combined losses were in the order of TShs 66 billion or Tshs 2-3 million per employee while the explicit and implicit fiscal losses exceeded 7% of GDP (URT, 1993b:3&4). The World Bank (1988) indicates that in 1982 eleven agricultural SOEs alone lost over TShs 2.2 billion and accounted for 80% of the total overdraft facilities of the National Bank of Commerce. At the end of 1992 the domestic and foreign debt of all SOEs amounted to Tshs one trillion (US\$ 2.7 billion) and two thirds of them could not service their debts while another third could not cover costs before debt service (World Bank, 1994:27f cited in Nkya, 1995).

There was a common denominator to the impact of the crisis: as the value of exports declined, imports declined leading to an acute shortage of raw materials, spare parts, and thus reducing drastically industrial capacity from 70% to 30% between 1970 and 1980. Consequently, an acute shortage of consumer goods and inputs to agriculture emerged, leading to further decline in production and a serious deterioration in capital stock of the key production and transport sectors.

Government revenue from production declined drastically necessitating an increase in taxes on already meagre incomes and few available goods. The falling government revenue led to the retrenchment of social services. To the common man the crisis was felt in terms of an acute shortage of consumer goods which started in 1980, reaching its peak in 1983/84 when the government was forced to liberalize the economy.

## Response: Ideological and Paradigm Shifts and Economic Policy Reforms

Economic policy reforms were a response to the economic crisis described above. The crisis triggered economic reforms directly and indirectly through paradigm and ideological shifts all over the world. Paradigm shift entailed a return to the prominence of neo-classical economics emphasising market-led development and the private sector as the engine of economic growth. Ideological shift entailed a change from socialist oriented state-centred economic development to free capitalist market economy. Figure 2.1 below depicts the shifts, the various forms of reforms undertaken leading to institutional changes, and the resultant restructuring of economic behaviour and incentives. Policy reforms led to institutional changes that in turn necessitated rebalancing of the public-private sector relationship.

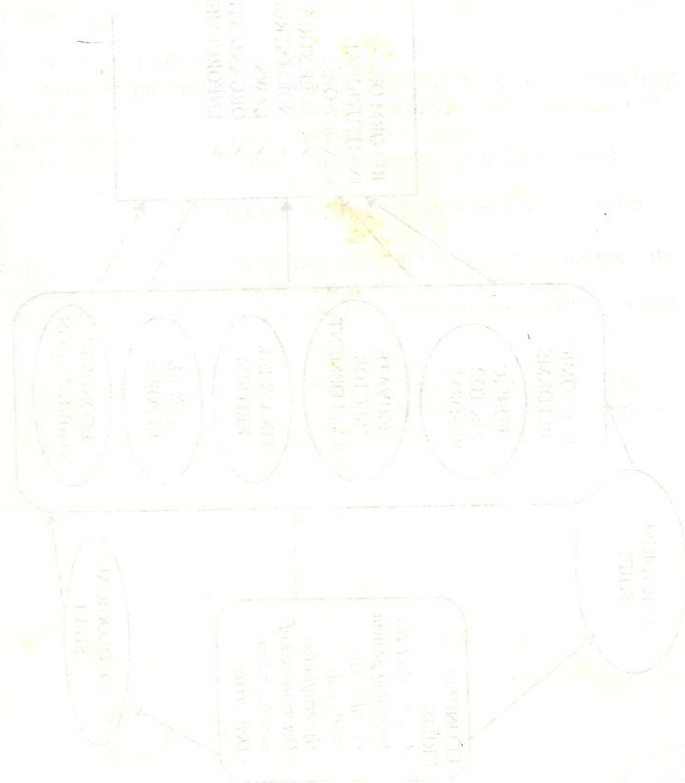
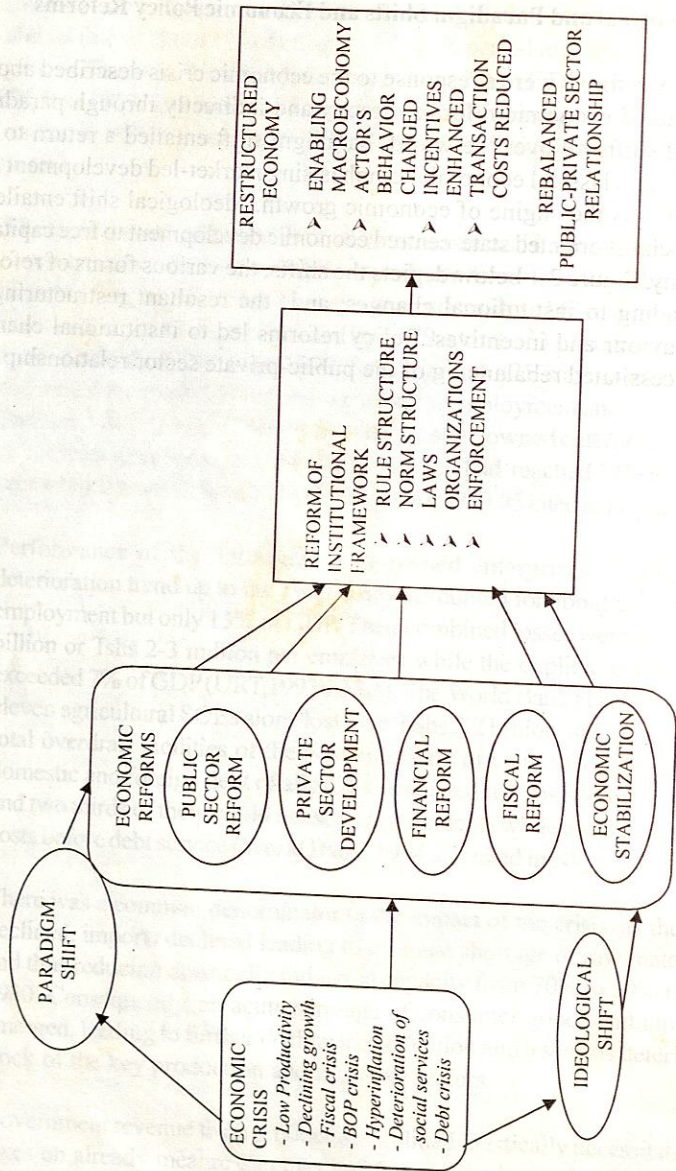


Figure 2.1: Analytical Model for Economic Policy Reforms



Source: Adapted from Nkya, E.J. (1995)

## First Generation Economic Policy Reforms (1980s) - A Response to Economic Crisis

The evolution of the economic policy reforms so far is categorised into two "generations", namely, first and second generation. The "first generation reforms" entail changes in economic policies under two major programmes - *stabilization* and *structural adjustment* - leading to judicious resource allocation. The reforms were/are based on the *Neo-classical* economic paradigm.

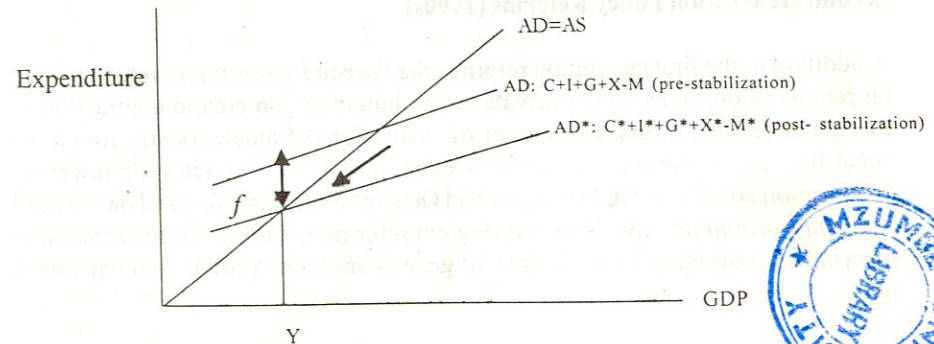
### Stabilization

Stabilization is associated with the International Monetary Fund and entails reducing balance of payments deficits and inflation to levels compatible with available resources and sustainable growth. The core of stabilization is reduction of aggregate demand to match with aggregate supply through sound macroeconomic management: fiscal, trade and monetary policy measures, characterized by:

- Shorter-run activity (usually one to two years);
- Reducing balance-of-payments deficits, primarily through correcting an overvalued exchange rate (devaluation or liberalization of foreign exchange market leading to depreciation of the Tanzanian Shilling);
- Reducing govt budget deficit through controlling expenditures and increasing govt revenue;
- Controlling the money supply, which in turn depends on reducing the budget deficit;
- Decontrolling of certain prices including interest rates and exchange rate, and eliminating government subsidies on goods and services;
- Targeted effort to reduce inflation to a single digit rate (from 31% in 1985 to 4.2% today).

In terms of economic analysis, *stabilization* involves bringing Aggregate Demand (AD) or *absorption* ( $AD = C+I+G+X-M = Y$ ) and Aggregate Supply (AS) into equilibrium ( $AD = AS$ ) (see Figure 2.2 below).

Figure 2.2: Macroeconomic Stabilization



Where,  $f$  = inflationary pressure,  $C$  = Aggregate Consumption,  $I$  = aggregate Investment,  $G$  = Government Expenditure,  $X$  = Total Exports,  $M$  = Total Imports.

### Structural Adjustment

Structural adjustment is associated with the World Bank and entails the following characteristics:

- Longer-term (three to five years) and more complex process with profound impact on the role of state in economic policy management;
- Adjusting prices to scarcity values (opportunity cost);
- Freeing the market to determine prices and allocate resources (liberalization);
- Shifting resources from govt to private sector decision making including privatization of state-owned enterprises and services (rebalancing public-private sector relationships);
- Rationalizing government's remaining roles in development so that some type of efficiency criteria are met (e.g. formation of executive agencies and civil service reforms;)
- Decentralization of management of national economy- giving more power and responsibilities to local governments, civil society and non-profit Non-Government Organization (NGOs).

Stabilization and structural adjustment constitute a radical *reallocation of economic and political power from the public sector to the private sector*. They entail a marked reduction of state involvement in the economy and enormous loss of opportunity for political benefits and rent-seeking, and also inevitable substantial cost to some sections of the population.

### Second Generation Policy Reforms (1990s)

In addition to the first generation reforms, the "second generation" reforms focus on removing obstacles to the private sector initiative, job creation, attraction of foreign investment, and adjustment of institutional framework to provide an "enabling environment" for various economic agents in view of lowering "transaction costs" (Nkya, 1997). Second Generation reforms focused on the need for *right institutions* capable of carrying out reforms and the need for *sustainable growth with poverty alleviation* (shared growth or quality growth), characterised by:

- Ensuring the rule of law and making the judicial system independent, professional and accessible to all.
- Dismantling monopolies and establish more transparent and effective regulatory systems.
- Increasing transparency in economic management (e.g. in the banking system).
- Increasing quality of public expenditure i.e. reducing outlays for unproductive purposes (e.g. military build-up, large projects that benefit only a few etc).
- Labour market reforms - market pricing of wages;
- Ensure effective assignment and enforcement of property rights;
- Enhancement of credibility of the economic policies and reforms.
- Good governance, where governance is defined by the World Bank as the manner in which power is exercised in the management of a country's economic and social development.

### Characteristics and Immediate Outcomes of Economic Policy Reforms

- Since most of the reforms emanated from economic crisis manifested in financial imbalances, the role of external institutions (International Monetary Fund and aid donor institutions) has been enhanced. Countries have been forced to allow these institutions some formal access to national policy making through external financial assistance which is usually accompanied by "conditionalities". *Conditionality* is defined by the International Monetary Fund as a remedial policy measure that member countries "agree" to take in conjunction with a financing facility.
- Enhanced role of technocrats and technical analysis arising from the technical orientation of donor agencies.
- International aid agencies tend to advocate uniform policy reform packages irrespective of specific country circumstances.
- Governments have been forced to adopt austerity programmes which have imposed hardships on their populations due to budget cuts, price increases and shelving of poverty alleviation programmes. Vulnerable groups have been hit more severely.
- Shifts in the location of political power and wealth arising from a shift from the state-centred to market-centred development. The power of the private sector and foreign capital has been enhanced. Consequently capacity of the state to control resources in order to wield power and influence has generally been diminished.

- Less Developed Countries like Tanzania are increasingly affected by the 'globalization' phenomenon.
- Policy reforms tend to be more difficult to carry out than before because they reduce the powers and privileges of the very government agents who are expected to approve and implement them. This dilemma has been characterized by Kahler (1990) as an 'orthodox paradox' as stated below

*The logic of SAP requires state agents to play a crucial role in the implementation of liberalization measures whose biggest victim will be the state sector itself. To what extent would the state elites implement effectively reforms which threaten their discretionary resources, rents and power? (Kahler, 1990 cited in Nkya, 1995).*

The new role of govt after reforms is to provide an "enabling environment" in terms of:

- Efficient infrastructure,
- Supportive policies for the private sector as an 'engine of growth',
- Good governance (rule of law, accountability, transparency, effective institutional arrangements) leading to political and economic stability,
- Sound macro-economic policy stance,
- Effective social policies (education, health and shelter).

### Conclusion

The ongoing rebalancing of public-private sector relationship in favour of the private sector in Tanzania is a response to the economic crisis of the 1980s against the background of world-wide economic paradigm and ideological shifts of the 1970s. The earlier heavy dependence on the public sector as an engine of growth and development, and subsequent persistent poor performance of the sector, precipitated the economic crisis.

The following chapter elaborates on the main strategy adopted in Tanzania to change the balance between the public and private sectors - the broad privatization of the state-owned enterprises. Privatization of state-owned enterprises includes modalities such as divestment, delegation and displacement. It is argued in the following chapter that rebalancing of the public-private sector relationship is conscious economic policy actions that require context-specific interventions.

### Discussion Issues

1. Describe the essence and causes of the economic crisis that engulfed Tanzania in the 1980s.
2. To what extent are the stabilization and structural adjustment programmes a response to the failure of the state-centred development policies of the 1960s and 1970s in Tanzania?
3. What is the nature of the Kahler's (1990) "Orthodox Paradox"? Suggest ways of going around (resolving) the paradox in Tanzania.
4. Are there any feasible alternatives to the economic policy reforms in Tanzania?
5. Characterize the major outcomes of reforms.

Theory, Perspectives and Strategies for Rebalancing Public-Private Sector Relationship

The Setting

Rebalancing public-private sector relationship is a conscious economic policy action that requires strategies based on relevant theoretical perspectives, good management practices and context-specific interventions. A major policy instrument employed in changing the balance between the public and private sectors is 'broad' privatization, which includes not only outright sale of public enterprises but also other modalities of privatization.

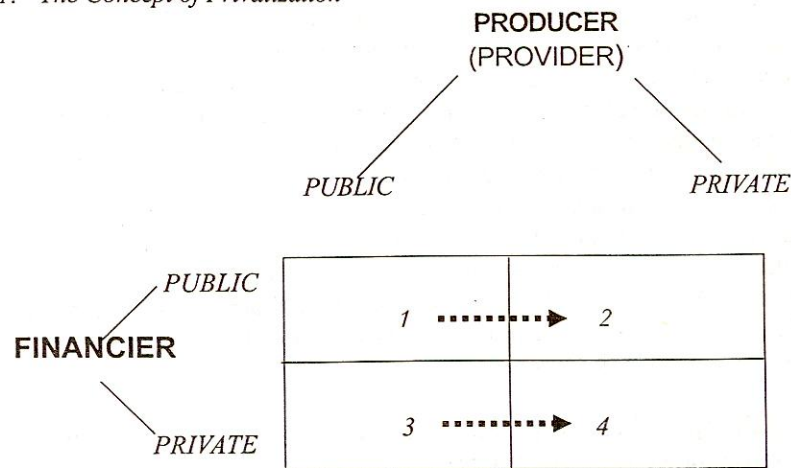
Countries like Tanzania, which for about twenty five years pursued state-centred development policies, were forced by economic circumstances to privatise almost all State-Owned Enterprises (SOEs) through various strategies and modalities discussed in this chapter. Privatization is therefore the main strategy employed to tilt the public-private sector balance in favour of the private sector.

The purpose of this chapter is to review various perspectives, strategies and modalities employed by less developed countries in rebalancing the public-private sector relationship. The main argument underlying the review is that perspectives and theories practised elsewhere are important in shaping the strategies and forms of changing the public-private relationship in a particular economy through the power and transfer of ideas.

Rebalancing Public-Private Sector Relationship through Privatization

In 'broad' terms privatization is defined as the transfer from the public to the private sector of ownership and control or control only of productive assets, production of goods and services, their allocation and pricing, and the entitlement to the residual profit flows generated by them. Table 3.1 below by Adam, et al (1992) depicts this definition, emphasizing both ownership and control, and focusing on financing and provision of service or good (see also Nkya, 2000).

Table 3.1: The Concept of Privatization



Source: Adapted from Adam, et. al, (1992), p6

- Quadrant 1 = public sector owns, controls and produces/provides.
- Quadrant 2 = public finances and private sector supplies (public contracts out).
- Quadrant 3 = private sector finances and public sector supplies (taxation case).
- Quadrant 4 = private sector owns, controls and produces/provides (private companies).

Moves from quadrants 1 and 3 to 2 and 4 represent 'broad' privatization (see dashed arrows), of which:

- Move from quadrant 3 to 4 represents direct sale of state-owned enterprises (private sector finances and provides).
- Move from 1 to 2 represents management contracts and contracting out or public-private partnerships (public finances and private sector supplies).

Dorado and Molz (1998) provide a similar broad definition in which privatization is the transfer of a going enterprise or enterprise assets from a public sector owner to a private sector owner or the transformation of a state-owned organization or a bureaucracy providing a public service into an autonomous organization whose performance is assessed using market-based criteria. A common argument underlying this definition is that the shift toward private sector ownership, control and methods will create organizations that are more flexible, innovative, efficient and customer responsive. The second part of this definition captures the restructuring or commercialization of public service bureaucracy.

The Organization of Economic Cooperation and Development (OECD) study by Bouin and Michalet (1991 cited in Nkya, 2000) caution against adopting a limited definition which considers only the transfer of ownership. They also caution against a too broad definition which tends to group under the term privatization all measures and policies aimed at strengthening the role of the private sector and hence bundling together very disparate measures such as liberalization, restructuring and deregulation, which may lead to difficulties of interpretation. In this context Bouin and Michalet (op.cit) define "effective privatization" as the application of private rationality by public economic agents who are responsible for the financial results (costs, losses and benefits) of an enterprise. Under this conceptualization the macro-level measures and policies aimed at strengthening the role of the private sector (liberalization, restructuring and deregulation) are not explicitly put under privatization. The measures create an enabling environment for broad privatization.

A study of privatization experience in Tanzania (Nkya, 1995) adopts a *broader* concept of privatization which combines conceptual elements provided by Savas (1989/90), Cook & Kirkpatrick (1988) and Adam, Cavendish and Mistry (1992). Savas (1989/90) conceptualizes privatization as a broad *policy process to improve the economic performance of government* and "a response to the recognized need for structural reform of government agencies, state enterprises and national economies" (p345). To privatize means *to rely more on the private institutions of society and less on government to satisfy people's needs*. It is the act of increasing the role of private sector and decreasing the role of government in an activity or in the ownership of assets. The private institutions referred to by Savas are comprised of three generic types: the market place; voluntary groups; and the family (clan, ethnic group, or an individual).

### Privatization Forces

Underlying the pressure to privatize the public sector is the observation that government has become too big and inefficient ("government failure" contrasted with "market failure") and that its functions and expenditures can be reduced by introducing various market mechanisms and encouraging increased participation of non-state organizations (World Bank, 1991; Shirley and Nellis, 1991). It involves "rolling-back" the state, a policy programme supported by theoretical justifications based mainly on the neo-classical economic ideas and policy prescriptions. The neo-classical paradigm favours the divestment form of privatization which involves transfer of ownership and control as pivotal ingredients (Nkya, 1995).

Savas (1987) provides four perspectives or forces that have driven the privatization movement since 1980s. The forces are summarized in Table 3.2 below.

Table 3.2: Privatization Forces

FORCE [PERSPECTIVE]	GOAL	REASONING [or ARGUMENT]
Pragmatic	Better Government	Prudent privatization leads to more cost-effective public service. <i>Part of an integrated development strategy for improving productivity of government agencies and thereby give people more value for their money through improvement of efficiency.</i>
Ideological	Less Government	Government is too big, too powerful, too intrusive in people's lives and therefore is a danger to democracy. Government decisions are political, thus are inherently less trustworthy than free market decisions. <i>Want to reduce the role of government and increase the role of the private sector.</i>
Commercial	More Business	Government spending is a large part of the economy; more of it can and should be directed toward private firms, state-owned enterprises and assets can be put to better use by the private sector. <i>Govt should redirect all commercial activities/services to the private sector.</i>
Populist	Better Society	People should have more choice in public services. They should be empowered to define and address common needs, and to establish a sense of community by relying more on family, neighbourhood, church, and voluntary associations and less on distant bureaucratic structures. <i>Populists are against both big government and big business (private bureaucracies). Privatization increases choices and strengthens traditional institutions and reforms a local sense of community.</i>

Source: Savas, E.S. (1987) *Privatization: The Key to Better Government*. Tata McGraw-Hill Publishing Co. Ltd. New Delhi, p.5

## Schools of Thought in Privatization

Dorado and Molz (1998:587) have identified two dominant schools of thought in privatization - *Neoclassical economics and Public Policy Schools*. The neoclassical school focuses on the first part of their definition above - the transfer of a going enterprise or enterprise assets from a public sector owner to a private sector owner - which the authors call *ownership privatization*. The Public Policy School focuses on the second part of the definition - transformation of a state-owned organization or a bureaucracy providing a public service into an autonomous organization whose performance is assessed using market-based criteria - which the authors call *market privatization*.

While the Neoclassical economists focus on issues of ownership, competition and markets, the Public Policy scholars focus on efficient attainment of public policy objectives. Neoclassical economists argue that the greatest social good will accrue from private ownership of the means of production in a competitive economy, and Public Policy scholars focus on delivery of services to all classes of the population, regardless of the ability to pay. Both agree, however, on the basic objective of privatization; to stimulate government organizations to be more *flexible, innovative, efficient and customer responsive*. In a critical analysis of the two schools, Dorado and Molz argue that both schools have overlooked that *strategy-structure-leadership-resource* issues mediate these supposedly self-solving dynamics, and this is the gap that forms the "*missing middle*" - the central theme of their paper.

While neoclassical economists tend to view the above issues as self-solving when the organization has a concentrated, profit-seeking ownership structure and operates in contested markets, the public policy scholars tend to view them as self-solving when sufficient resources are available and adequate *objective standards of performance* are set.

Citing Miller (1984), Dorado and Molz (1998) argue that because privatization implies a radical change process for the organizations affected public sector reform cannot ignore *organizational theory*. "To achieve the objectives sought by both the neoclassical economist and public policy schools of thought often requires the restructuring of organizations, resulting in reduction of employment, decentralizing and reshaping of the industrial relations of the organization" (quoting Colling and Ferner, 1992). According to Dorado and Molz (1998) both schools (Neoclassical and Public Policy) theorists "acknowledge the presence of these issues but often ignore how the organizational changes affect the final outcome of privatization or enterprise reformation. Both have focused, instead, on measuring the performance of organizations before and after they were privatized; disregarding what happened in between - *the missing middle*" (p584). Table 3.3 below summarizes the various arguments and dimensions of the two schools of thought.

Table 3.3: *Dominant Schools of Thought in Privatization*

	<i>Neoclassical Economics School</i>	<i>Public Policy School</i>
<i>Concept of Privatization</i>	Transfer of Ownership: ⇒ <i>Transfer of a going enterprise or enterprise assets from a public sector owner to a private sector owner</i>	Transformation of Organization: ⇒ <i>Transformation of a state-owned organization or a bureaucracy providing a public service into an autonomous organization whose performance is assessed using market-based criteria</i>
<i>Theoretical framework</i>	Property Rights Theory: ⇒ <i>Separation of property between private shareholders (owners) and managers;</i>  ⇒ <i>agency theory provides incentive structure to managers</i>	Public Choice Theory: ⇒ <i>Making the public sector subject to the discipline of the market;</i>  ⇒ <i>Benefits from maximizing utility within a collectivity of value maximizers</i>
<i>Analytical framework</i>	Ownership and Markets: ⇒ <i>Efficacy of private ownership and competitive markets; or competition;</i>  ⇒ <i>Difference between private ownership and public ownership;</i>  ⇒ <i>Direct relationship between organizational performance and property rights</i>	Competition and Objective Standards: ⇒ <i>Centrality of objective standards obtained through benchmarking</i>  ⇒ <i>Attain efficiency without renouncing the public policy goals;</i>  ⇒ <i>Introducing private incentives to public managers</i>
<i>Implementation mechanism</i>	Agency Theory: ⇒ <i>Ownership privatization;</i>  ⇒ <i>Ownership and management separated</i>	Responsive Bureaucracy ⇒ <i>Market privatization;</i>  ⇒ <i>'Redundancy' (concurrent delivery of public services by several agencies);</i>

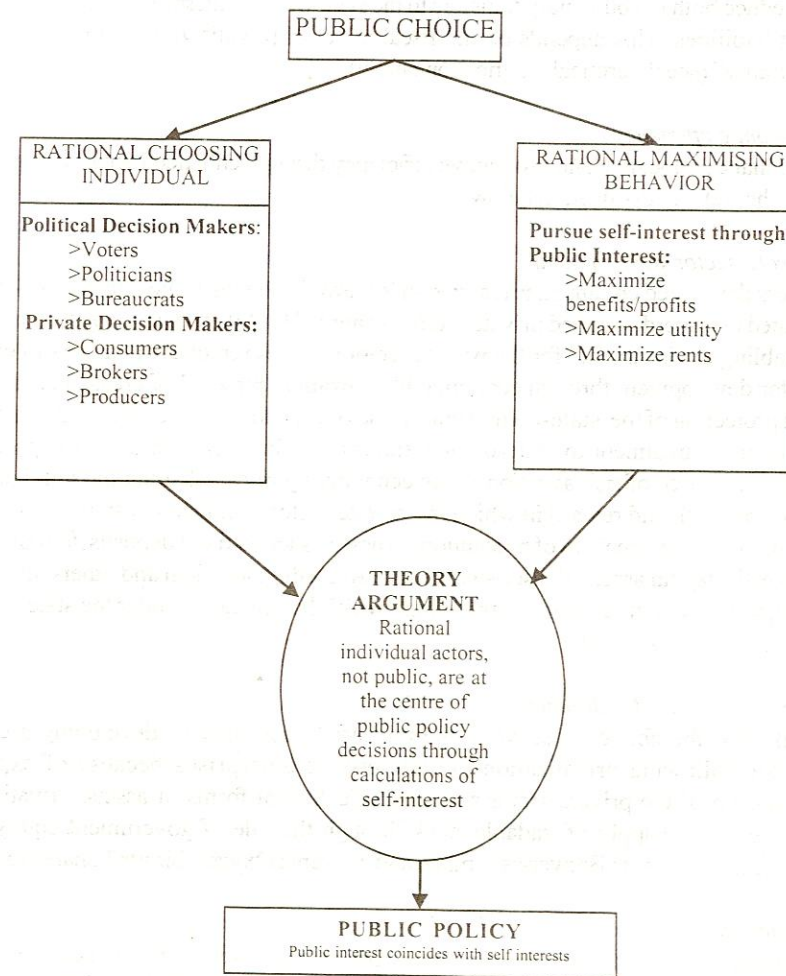
	⇒ Owners establish incentive and monitoring mechanisms to ensure manager maximizes the owners' utility;	⇒ Leads to increased competition; Provides comparable benchmarks of performance and enhances efficiency);
	⇒ Incentives and monitoring raise costs for the owners that they will endure only if subsequent benefits exceed subsequent costs;	⇒ Professional administration (efficient, objective, equitable and responsive) guided by objective standards in decisions and performance;
	⇒ Focus on results not process	⇒ Focus on results not process

Source: Adapted from Dorado, S. & R. Molz (1998) 'Privatization theories and missing middle', *International Review of Administrative Sciences*, 64(4)

### Public Choice Theory

At the centre of public policy school is *Public Choice Theory*. The focus of the public choice theory is a "choosing individual" and a "maximising behaviour". It is argued that individual actors, not public, are central in public policy decisions. Both political decision-makers (voters, politicians, bureaucrats) and private decision-makers (consumers, brokers, and producers) behave in a similar way, that is, they all follow the dictates of *rational self-interest* - to maximize benefits. Public Choice Theory assumes that individuals make rational decisions based on calculations of self-interest. Public servants should not, therefore, be expected to pursue a *public interest* that does not coincide with their own self-interests. Figure 3.1 below summarises the public choice theory as described here.

Figure 3.1: Public Choice Theory Framework



Source: Developed from Literature Review

## Policy Objectives of Privatization

### *Fiscal objective*

To reduce both net budgetary transfers to the state-owned enterprises and government debt liabilities. This depends on the fiscal effect of privatization in terms of “fiscal neutrality” (see theoretical justification below).

### *Economic efficiency*

To enhance allocative and productive efficiency through enhancement of competition (see theoretical justification below).

### *Private sector development*

In less developed countries, privatization is viewed as an instrument to “crowd-in” the stunted or underdeveloped private sector. As argued by Adam et al. (1992), creating an “enabling environment” for the private sector requires removal of barriers to private sector development through economic liberalization, removal of cross-subsidization and protection of the state-owned enterprises (soft budget constraint), and conferring preferential treatment to state-owned enterprises. Privatization is also expected to alter the degree of risk aversion in the economy by re-establishing the link between economic risk and reward in which the private sector is induced to switch from asset accumulation in the form of precautionary assets, such as fixed deposits, to more risky domestic capital assets, (‘asset-switching’). According to Adam and others, this helps the government in reversing capital flight which has occurred under the state-centred development approach.

### *Capital market development*

Linked to the above objective is the increased possibility of developing a capital market following privatization of state-owned enterprises because of expected expansion of the private sector and diversification of forms of assets. Privatization augments the supply of tradable stock through the sale of government equity (e.g. offering of Tanzania Breweries Limited and Tanzania Oxygen Limited shares for sale).

### *Income distribution*

This depends on the form or strategy of privatization adopted. For example, direct private sale of state-owned enterprises may lead to concentration of equity wealth while public offer of shares on the stock exchange provides for a broader share ownership and several small scale investors.

### *Meeting aid conditionalities*

Privatization is one of the major policy conditions set by aid donors before fund disbursements are effected.

### *Reduction of administrative burden on the government bureaucracy*

Relieves the government of administrative burden to concentrate on the basic public goods including law and order, public health, etc.

## Theoretical Justification for Privatization

Two main theoretical justifications or arguments have been advanced in defense of privatization (divestiture) in Less Developed Countries: fiscal gain and economic efficiency gains (productive and allocative efficiency) (Nkya, 1995 citing Galal, 1990 and Adam, Cavendish and Mistry, 1992). Killick and Commander (1988 cited in Nkya, 1995) have added “distributional efficiency” in which divestiture is expected to lead to increased real incomes of consumers due to increased competition leading to lower production costs and prices.

According to Galal (ibid), the *fiscal gains* of divesting state-owned enterprises depend essentially on: the value of the assets sold; the increase or decrease in productivity resulting from transfer of ownership; the budgetary impact of the state-owned enterprises being divested (tax revenues and cut in government subsidies); and the way governments utilize their receipts from the sale of state-owned enterprises or fees from the other forms of privatization.

In an ideal theoretical case, however, in the long run divestiture through the sale of state-owned enterprises can result in “neutrality” of fiscal incidence if the buyers paid a price equal to the discounted stream of net revenues the government would receive under continued public ownership, or if the change in ownership left efficiency, profitability, and income taxes unaffected. *Fiscal neutrality* could also occur if the state-owned enterprise being sold had imposed no burden on the government budget. Under these conditions of fiscal neutrality, only composition of government assets would change due to divestiture, the substitution of liquid assets for equity. The overall budgetary balance would have improved today but at the expense of future balances. It means divestiture by sale of state-owned enterprises may have no fiscal impact in the long term (Galal, 1990; Adam, Cavendish and Mistry, 1992 cited in Nkya, 1995).

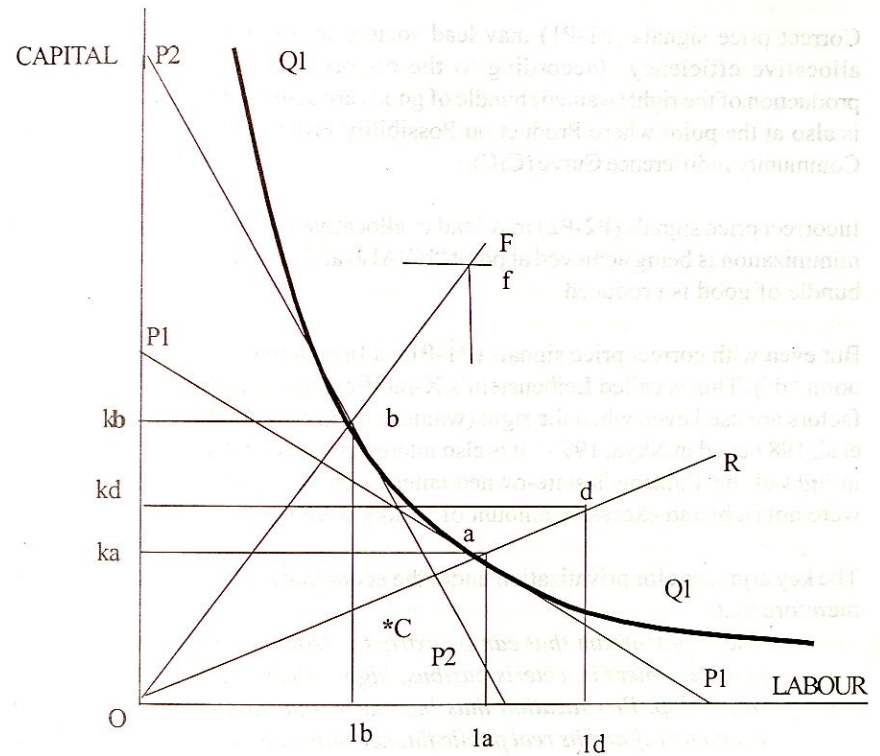
In practice, however, the neutrality of fiscal incidence is unlikely due to three reasons. First, on the expectation that they can increase profitability, buyers may pay a price

higher than the discounted stream of profits that the government would receive under continued public ownership. Second, the fiscal burden on government budget imposed by state-owned enterprise may be alleviated. Third, given the experience with fiscal deficits, governments may have an incentive to use the sale proceeds to reduce the deficit (Galal, 1990 cited in Nkya, 1995).

But even at this theoretical level the causes of these variations can be speculated on the basis of the nature and characteristics of governments in Sub-Sahara Africa (weak capacities and corruption). These may lead to a buyer paying a price lower than the real value of the enterprise. Also the desperate fiscal situation and inadequate state capacity may weaken the government's negotiation stance, leading to accepting unfavourable deals. It is also possible that the government may perceive the sale proceeds as "windfall" revenues and be motivated to increase public expenditure thereby aggravating further the public budget deficit (ibid).

Justification for economic efficiency gains is based on the neo-classical economic theory which associates efficiency outcomes with competitive market structures and private ownership. It is argued that divestment (privatization) will enhance allocative and productive efficiency. Allocative efficiency gains are expected to result from the allocation of resources according to their scarcity values (opportunity cost) as dictated by resources relative prices, to produce the right (wanted) bundle of goods. Productive efficiency gains are expected to arise from an optimal use of inputs within an enterprise leading to lower cost of production (see Figure 3.1 below).

Figure 3.1: Production and Allocative efficiency



Q1-Q1: Isoquant (equal product curve)

P1-P1: Correct relative price line (isocost) for the two factors of production as determined by supply and demand. It reflects relative opportunity cost of the factors.

P2-P2: Incorrect relative price line resulting from distortive government policies (e.g. minimum wage or undervalued capital).

OR: Indicates production with identical ratios of labour and capital use without distortions.

Points "a" and "b" are both *technically (productive) efficient* (least cost of production). Point "d" is possible but not efficient (too much of both factors).

Point "C" is unfeasible as an alternative for production of output  $Q_1-Q_1$  because the amount of each factor is not sufficient to attain that level of output  $Q_1-Q_2$ .

Correct price signals (P1-P1) may lead society to a point like "a" where both allocative efficiency (according to the opportunity cost of resources) and production of the right (wanted) bundle of goods are achieved. Allocative efficiency is also at the point where Production Possibility Frontier (PPF) is tangent to the Community Indifference Curve (CIC).

Incorrect price signals (P2-P2) may lead to allocative inefficiency, even when cost minimization is being achieved at point "b". Also at that point, a wrong (unwanted) bundle of good is produced.

But even with correct price signals (P1-P1), a firm may not minimize costs (as at point "d"). This is called Leibenstein's X-inefficiency in which too much of both factors are used even when the right (wanted) bundle of goods is produced (Gillis et al, 1987 cited in Nkya, 1995). It is also interesting to consider point "f" on line OF in light of the Tanzania's state-owned enterprises during the 1980s, when prices were not right and excessive amount of factors were used.

The key argument for privatization under the economic efficiency gain objective is therefore that:

*The profit stream that can be extracted from the assets in the hands of private owners is, ceteris paribus, higher than if operated under public ownership. Privatization thus increases total factor productivity in the economy [...] and its real public finance impact arises out of the additional tax revenues generated from the enhanced value of the assets realized under private ownership (Adam, Cavendish and Mistry, 1992: 12)*

The neo-classical economic model which explains the above efficiency outcomes (gains), is based on two fundamental institutions of the market: flexible prices and property rights. Free market is a system of voluntary transactions between independent property owners pursuing their self-interest, while property rights (of ownership and use of property) are meant to establish and protect private ownership of resources. Flexible prices are determined by the market forces of supply and demand. Based on the economic notion of scarcity of resources, the model focuses on the micro level of economic activities and postulates a rational maximizing behaviour by economic agents - a price constrained maximization of satisfaction (utility) by consumers and profit maximization by firms. The market forces of supply and demand, if undisturbed by state intervention or other market imperfections, are

expected to determine equilibrium market clearing prices among different markets (Meir, 1983:13-14 cited in Nkya, 1995).

In regard to production under competitive conditions and flexible prices, the model asserts that possibilities of factor substitution enable producers to search for a "least cost" of production by combining factors of production in different proportions to achieve a profit maximizing output. In the long run, when all the factors of production (variable and fixed) can be varied and the economies of scale are exhausted, firms are expected to produce at the lowest average cost of production.

Four key assumptions underlie this ideal competitive neo-classical production model. First, there are a large number of firms in the market which are similar in size and power. Second, there is freedom of entry of other firms into the industry such that, in the long run, all will be making "normal profits" just enough to cover the cost of capital and the opportunity cost of entrepreneurship. Third, each seller is a "price taker" facing a price set by the market for its product. Fourth, information is readily available such that uncertainties about market conditions are minimized (ibid).

Ultimately, the expected ideal outcome of the neo-classical model is the "Pareto Optimum" in which it is impossible to increase the welfare of any individual without decreasing the welfare of another individual. The "pareto optimum" links welfare with choice - the greater the range of choice the greater the feasible level of social welfare, and that markets increase choice while non-market allocations inhibit choice (Caporaso and Levine, 1992 quoted in Nkya, 1995). Following Adam Smith, it is also asserted that the pursuit of individual/private interest through the "invisible hand" of the market promotes the interests of society as a whole - "the invisible hand thus assures the harmonization of private interest and public interest" (Meir, 1983:1 cited in Nkya, 1995).

The neo-classical model recognizes, however, the possibilities of market imperfections in three forms. First is "externalities" which refer to "a set of effects of transactions on persons not party to those transactions" (Caporaso and Levine, 1992:90 cited in Nkya, 1995) or side effects in resource use that falls outside the market mechanisms and hence unpriced or difficult to price (Meir, 1983 cited in Nkya, 1995). Second is the special nature of public goods - non-excludability and non-rivalness that lead to "free rider" problem. Third is the existence of induced or natural monopoly conditions which distort the working of free market. These aspects tend to limit the achievement of the ideal outcome. These market distorting realities notwithstanding, the protagonists of the neo-classical model argue that policy makers should, as much as possible, allow the market forces to work towards the ideal outcome; in the end even the second best outcomes would be better than the state-led production through the SOEs.

## Strategies and Modalities of Privatization

According to Savas (1989/90), government activities or state-owned enterprises can be privatized [broad definition] through three broad alternative strategies and modalities: *divestment*, *delegation* and *displacement*. The terminology, definition, and classification of these three forms/strategies described below are adopted from Savas with slight modifications (Nkya, 2000).

**Divestment** (or divestiture) involves transfer of ownership and control of a state-owned enterprise to the private sector through outright sale (by private placement, public sale, employee buy-out and sale to users) or donation. This is the narrow concept of privatization as championed by the protagonists of the "privatization movement" including the international aid agencies.

Under **delegation** the government delegates to the private sector part or all of the activity of producing goods or services but retains the responsibility to oversee the result. It requires a continuing active role for the government. Delegation is carried out through five main modalities: contract, franchise (concession) and lease, grant, and voucher. *Contracting* involves contracting-out an activity to the non-state sector over a specified period. *Franchise* involves awarding a private organization an exclusive right to sell a service or good to the public over a specified period and area in exchange for a fee. Two variants of franchise are *concession* (suitable for public domains such as air space or utilities), and *lease* (renting a government-owned asset for use by the private sector).

*Concession* is a contractual arrangement through which a private firm obtains the right from government to provide a service under conditions of significant market power. Asset ownership remains in public hand but the private operator is responsible for new investment as well as operating and maintaining existing assets. Concessions are typically used for introducing private participation in infrastructure and other natural monopolies. Contract arrangements include performance-based management contracts, leases, build-operate-transfer and divestiture under license, which have various degree of underlying risk allocated to public and private parties. In *leases* the concessionaire is paid no fee by the government and profits of the concessionaire depend directly on the operating profits. Operating risk is thus fully transferred to the private operator. The government maintains responsibility for investment and thus bears investment risk (World Bank, 2006).

Delegation by *grant* involves providing a subsidy to a private entity so that it can deliver a service to the public. Delegation by *voucher* involves issuing vouchers

(exchange instruments for a specific good or service) to eligible beneficiaries of formerly state-run services now produced by the private sector in the market place.

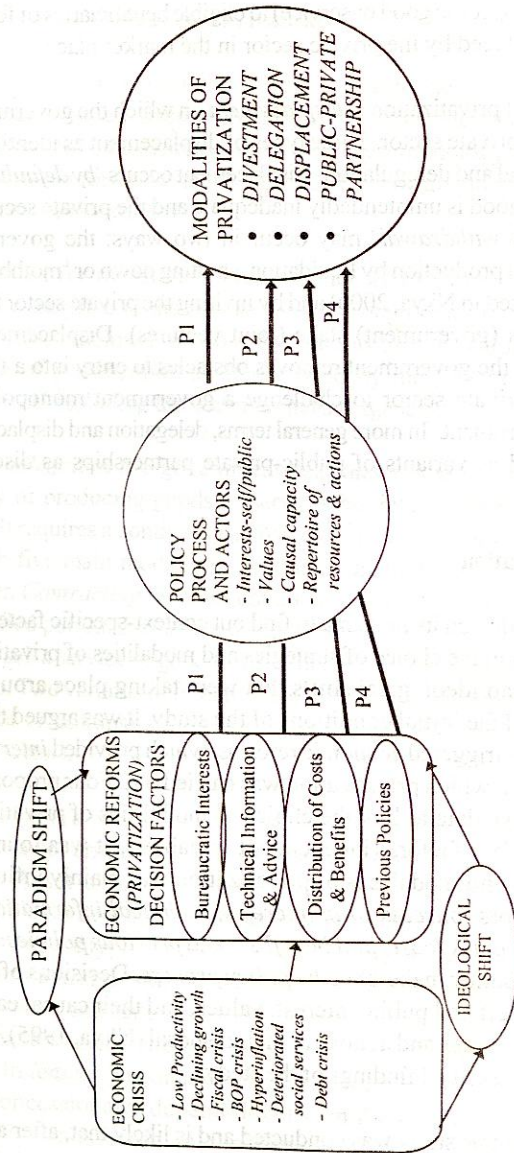
The third alternative form of privatization is **displacement**, in which the government is gradually displaced by the private sector. Three types of displacement as identified by Savas are default, withdrawal and deregulation. Displacement occurs '*by default*' when the government service or good is unintendedly inadequate and the private sector fills the gap. Displacement '*by withdrawal*' may occur in two ways: the government withdraws deliberately from production by liquidation, shutting down or 'mothballing' (Shirley and Nellis, 1991 cited in Nkya, 2000) and by inviting the private sector into an activity while shrinking its (government) stake (joint ventures). Displacement '*by deregulation*' occurs when the government removes obstacles to entry into a field of activity and enables the private sector to challenge a government monopoly and eventually displace the government. In more general terms, delegation and displacement could loosely be identified as variants of public-private partnerships as discussed earlier in chapter five.

### Empirical Study of Privatization

In 1994/95 a study was conducted in Tanzania to find out context-specific factors that influenced policy decisions in the choice of strategies and modalities of privatization (Nkya, 1995). Paradigm and ideological shifts that were taking place around the world at that time provided the initial conditions of the study. It was argued that the economic crisis of the 1980s triggered economic reforms, which provided *intervening contextual conditions* within which privatization was carried out. Four propositions were tested using qualitative data to link the choice of modalities of privatization (dependent variable) and four factors (independent variables). It was found that policy choice of strategies and modalities of privatization was mainly influenced by the following four factors: *bureaucratic interests*; *technical information and advice*; *distribution of outcomes (costs and benefits)*; and *previous policies*. These factors influenced *actors* (policy makers) in the *policy process*. Decisions of policy makers were mediated by self and public interest, values, and their causal capacity in terms of repertoire of resources and actions at their disposal (Nkya, 1995). Figure 3.2 below summarises the described findings of the study.

It is now several years since this study was conducted and is likely that, after a series of economic reforms leading to a change of context, these factors may currently influence policy choices differently to lead to different outcomes.

Figure 3.2: Framework of Analysis for the Choice of Modalities of Privatization



Key: P = Proposition

Source: Nkya, E.J. (1995): p.76

## The Role of Government after Privatization

Rondinelli (1990) argues that current reforms entail pushing back the public sector in order to open space for the private sector even within the sphere of public goods. The role of government is to create an 'enabling environment'; to ensure the "conditions under which public goods and merit goods will be delivered and the conditions for the control of monopolies and for the financing of large scale investments, without having to perform the service itself" (Batley, 1994:8). The government's role is, therefore, to ensure "provision" which is a part of "supply". The World Bank (1992), and Ostrom, Schreder and Wyne (1993) have distinguished two components of "supply" - *provision* and *production*.

*Provision* is the "act of ensuring that a given good is available and might involve decisions about quantities and qualities, arrangements for production, financing, regulating and enabling producers" (Batley, 1994:8). Provision may include activities such as establishing policy or planning frameworks and enforcing their implementation; ensuring standards of service and the availability of information; financing, advising, enabling, coordinating, regulating and licensing private producers; maintaining ownership rights but contracting producers.

*Production* is the "act of physically generating, delivering and maintaining the good" (Batley, 1994:8). Production may include the construction of plant or facilities, their maintenance or the management of service delivery.

## Critique of the Privatization Theory

The theoretical justification (arguments) advanced so far are predicated on assumptions not immediately relevant for many SSA countries. In Tanzania, for example, induced or natural market distortions are still in place, capital market has just recently been established, experienced entrepreneurs are in short supply, inter-sectoral (backward and forward) linkages are weak, and institutional capacity of governments to regulate private monopolies is limited. It is also assumed that the context in which the theory has to operate is one in which the society-centred policy making is practiced and various interest groups are well organized. That has not, however, been the case in several African Less Developed Countries in which policy making is centred mainly in the state structures. The situation of interest groups related to privatization in Tanzanian which support this critique is discussed elsewhere (Nkya, 1995).

Further, non-monetized subsistence economy is considerably large in many African economies. In Tanzania, for example, about 33% of the Gross Domestic Product is still

accounted for by the non-monetized subsistence economy which does not respond to market price signals. Under these conditions, allocative and productive efficiency based on "formal" market structures will not be realized and economic reforms based on their assumptions may not work effectively at the beginning of reforms (Nkya, 1995).

Another major critical observation against the above theoretical justifications is that the impact of divestment is likely to weigh disproportionately on certain groups in society, and that these groups will typically be the relatively underprivileged (De Walle, 1989:606; Bouin and Michalet, 1989). For example, prices for certain goods and services may increase dramatically after divestiture if cross-subsidization practices are abandoned. As argued by Nellis and Kikeri (1989), however, this argument against divestiture is tenable only if it can be shown that public provision is the most effective and efficient manner of reaching the poor. Otherwise, direct targeting of the poor could be a more cost effective approach. It is worth noting here that some of the alternative forms of privatization described below under "delegation" (voucher or grant) may facilitate the direct targeting of the poor.

The theoretical justifications reviewed in this section, which are expected to determine the privatization policy content, rely significantly on the neo-classical assumptions about economic structures found in the More Developed Countries where market structures are competitive, threat of entry is credible, and which have fewer regulatory distortions, larger markets, and better institutional capacity to mobilize savings for equity. It is further argued that political contexts, within which divestiture programs are adopted and implemented, influence the outcomes in terms of speed, forms and impact of privatization (Nkya, 2000).

This theoretical review indicates that justification for privatization in several Less Developed Countries, and particularly in Tanzania, cannot be based solely on the market-based property rights and market contestability theories. As Adam, Cavendish and Mistry (op.cit.) argue "changing ownership itself will not be sufficient and may not even be necessary to elicit performance improvements. Rather, competition and regulation policy will emerge as major determinants of the effect that privatization will have on economic efficiency" (p18).

### Conclusion

Broad privatization was adopted in Tanzania to change the balance between the public and private sectors. Broad privatization of state-owned enterprises included three modalities: divestment, delegation and displacement. It has been argued that

the rebalancing of public-private sector relationship was context-specific conscious economic policy action. It has also been argued that merely changing ownership would not be sufficient or even necessary to elicit performance improvements. Rather, competition and regulation policy are emerging as major determinants of the effect that privatization will have on economic efficiency. Justification for broad privatization was driven by economic and allocative efficiency gains based on the neo-classical economic theory which associates efficiency outcomes with competitive market structures and private ownership.

### Discussion Issues

1. *Using any relevant criteria, distinguish between the Neoclassical and Public Policy schools of privatization. How could you analytically compare the Savas (1987) "forces" of privatization and Dorado & Molz (1998) schools of thought?*
2. *In terms of goals and strategies, elaborate the distinction between "better government" and "less government" in the Savas (1987) categorization of forces (perspectives) underlying privatization.*
3. *In terms of goals and strategies elaborate the distinction between "less government" and "better society" in the Savas (1987) categorization of forces (perspectives) underlying privatization.*
4. *Using Dorado and Molz's (1998) "missing middle thesis", assess the importance of organization theory.*
5. *Given the Tanzania's privatization experience so far (see PSRC Annual Reports), provide some examples of privatization cases for each form/strategy presented above.*
6. *In the context of the political and socio-economic situation in Tanzania, which forms/strategies of privatization are likely to dominate the process? Why?*
7. *Provide at least three arguments why any one of the following SOEs should be or not be privatized: TANESCO, NIC, CDTI (Tengeru), NPF, ALAF, NBC, and NHC. In the case of privatization, what strategies and modalities would you recommend? If privatization is not recommended, how could efficiency and effectiveness be enhanced in such enterprises?*
8. *Under what conditions would fiscal neutrality occur in the privatization of state-owned enterprises in Tanzania?*
9. *It is contended that the differences in enterprise performance under public and private ownership are not intrinsic and hence ownership may not*

influence performance variations. Discuss this contention in the context of the "principal-agent theory".

10. Changing ownership alone is not sufficient and may not even be necessary to elicit performance improvements in large and complex enterprises. To what extent do you subscribe to this contention?
11. To what extent do the following aspects of the public sector influence the process, output and impact of privatization?
  - Capacity to effectively regulate a market economy
  - Policy choice of strategies and modalities of privatization
  - Legacy of previous policies
  - Leadership and economic governance.

## Agency Theory and Public and Private Sector Managerial Performance

### The Setting

In the neoclassical model there is no discernable direct and clear causal link between private ownership and economic efficiency (Bouin and Michalet, 1991; Galal, 1990). Why is private ownership advocated for enhancing performance even in light of the above assertion? The case for superiority of private ownership and control in private goods is presented in this chapter.

The purpose of this chapter is to review some relevant arguments linking private ownership and control with performance by employing the agency theory to compare public and private sector managerial performance. The central argument in the review is that rebalancing public-private sector relationship requires an appropriate institutional framework that creates viable free market economy conditions and enables the principal to design an appropriate reward structure for the agent to deliver requisite benefits.

### Comparing State-Owned and Private Enterprises

In the neo-classical model discussed in chapter three, private ownership is important because, among other things, it is expected to lead to a "multitude" of market players (assuming there is no concentration of ownership) and hence to facilitate competition. While there is no direct and clear causal link between private ownership and economic efficiency in the neoclassical model, private ownership is, however, advocated because it will avoid those performance and efficiency constraints inherent in the state ownership (Bouin and Michalet, 1991; Galal, 1990 cited in Nkya, 1995). The constraints in state ownership include the Kornai's "soft budget constraint" in which the public enterprises are assured of a bail-out if their financial situation deteriorates; failure is more likely to bring a fund infusion by the government than is success (Prager, 1992 cited in Nkya, 1995). According to Raiser (1996 cited in Bangura, 2000:17) the Kornai's "soft budget constraint" entails unlimited access to subsidies and grants, soft credit systems and preferential treatment in tax rates. It reduces the incentive to minimize costs.

The state-owned enterprises are often used by governments to pursue *non-commercial objectives* which are inconsistent with efficient and financially viable performance

(Adam, Cavendish and Mistry, 1992 cited in Nkya, 1995). These objectives include: employment maximization, non-commercial price setting aimed at inter-sectoral cross-subsidization (keeping prices low for other sectors), equity (distributional), and political patronage (positions in state-owned enterprises offered to political supporters). In most cases the *objectives are multiple and contradictory* (such as surplus creation against equity or balancing regional development) and the situation is made worse by bureaucratic meddling by government officers and perverse regulatory prices (World Bank, 1983).

Private ownership, on the other hand, is assumed to be free of the non-commercial objectives. Profit maximization, which is more measurable, is the major objective. The level of monitoring of management performance by owners is also assumed to be higher than in public ownership. This difference in monitoring derives from the "concentration" of property rights over the assets in the private ownership in contrast to the "dissipation of property rights under public ownership [citizens/electorate as owner] which severs the link between asset ownership and its ultimate control and management" (Adam, Cavendish and Mistry, *ibid.* p13).

Both in theory and practice, however, the issue of the relationship between ownership and performance in terms of economic efficiency is far from settled. The assertion about institutional and management control differences between public and private ownership is too simplistic for explaining performance variations between the two types of ownership. In modern industrial organization, for example, in both state-owned enterprises and large private corporations, ownership is divorced from management and therefore managers of both organizations are likely to maximize objectives different from and often incompatible with profit maximization (Galal, 1990). It is therefore contended that the differences in enterprise performance under public and private ownership are not intrinsic. Adam, Cavendish and Mistry (*ibid.*) invoke the Principal-Agent theory to argue that "such differences [in performance] are grounded in the disparity between the objective functions of public and private sector owners and the different forms of agency relationships the ownership structure engender" (p14).

The pressure on the private sector to avoid excessive non-profit activities and reduce operating costs arises from the assumed competitive or "contestable" market condition created by the possibility of free entry of new competitors. A *contestable market* is one in which any firm is continuously exposed to actual or threatened competition from efficient producers who can enter the market at low cost, undercut the incumbent's price and acquire market share. The threat of this profit-reducing competition is thus the spur to efficient operations by all firms in the market (Adam, Cavendish and Mistry,

1992). It is assumed that "entry-deterrence" (national interest, patenting, advertising, capital intensity, collusive behaviour) can be reduced or eliminated and the number of firms available is large enough to lead to this effect, a production condition that is difficult to be found or to develop in the short run in several African economies (Nkya, 1995).

In the public sector, unlike in the private sector, however, there is a "complex agency chain" that links the electorate, legislature, executive and bureaucracy. In that context it is argued that:

*While political success (i.e. continuation in office) may depend, inter alia, on meeting the concerns of the electorate about SOE performance, pursuit of economic efficiency in public enterprises is actually more likely to be subordinated to meeting the concerns of specific interest groups. This is strongest when the benefits of efficiency gains to the electorate are dissipated widely, and the adjustment costs fall principally on an active [organized] political group. [...] The political power of such interest groups will determine how far the electorate's concerns are transmitted into political action to reform the state-owned enterprises (Adam, Cavendish and Mistry, 1992:15)*

The example given to illustrate the above theoretical argument is that, in a situation of chronic over-staffing of state-owned enterprises which adversely affects the electorate/citizens (i.e. higher consumer prices due to higher costs of production), the costs of adjustment (cuts on employment) will fall primarily on organized labor. But since labor is organized or can organize itself more easily, it can fight against employment cuts (i.e. block privatization of state-owned enterprises) and thus maintain higher costs of production and higher consumer prices (if demand is inelastic). The consumers, on the other hand, may not be able to organize themselves as effectively as labor to support the employment cuts which would lower consumer prices. Therefore, although the electorate may be dissatisfied with the performance of state-owned enterprises, the power of those to whom the rents from inefficient state-owned enterprises are accruing will ensure that the general concern is not addressed (Adam, Cavendish and Mistry, 1992).

### Premises of Agency Theory

According to Douma and Schreuder (1991), agency theory discusses the relationship between two people, a principal and an agent who *makes decisions on behalf of the principal*. The agent's decisions or actions affect the principal's assets defined broadly as wealth, health, reputation, etc. Examples of agency relations are:

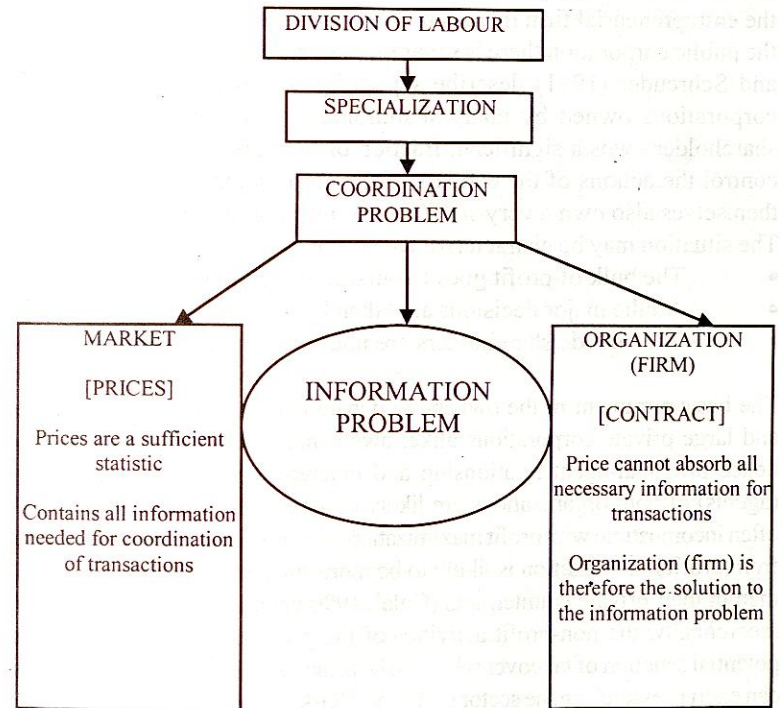
- The owner of a firm (principal) and the manager of a firm (agent), who makes decisions affecting the owner's wealth.
- The owner of an estate (principal) and his steward (agent), who makes decisions affecting the owner's wealth.
- A manager (principal) and his subordinate (agent), who makes decisions affecting the manager's reputation.
- A patient (principal) and his physician (agent), who makes decisions affecting the patient's health.
- An insurance company (principal) and a person holding a fire insurance policy (agent), who makes decisions affecting the insurance company's cash flows.
- A lessor (principal) and a lessee (agent), who makes decisions affecting the lessor's property (Douma and Schreuder, 1991:77).

Douma and Schreuder (1991) have shown that division of labour, specialization and information problems, which are necessary in a modern economy, have to be coordinated. In markets, the price system is the coordinating device and in organizations or firms, authority and contract are the coordinating devices. The organization or firm answers the age-old question asked by Ronald Coase in 1937: why are all exchanges not executed through the free market? Coase argued that markets and organizations are alternatives for executing transactions. Relative transaction costs determine which alternative is chosen for coordination. The alternative with the lowest transaction cost will be chosen. Information asymmetries among economic actors determine the relative costs of transaction. Figure 4.1 below depicts a conceptual framework for this argument.

In organizations, some coordination is always needed to align common organizational goals with selfish interests and incentives of individual members. Contractual clauses in organizations try to describe the general features of incentives that make both parties as well off as possible. A contract is a coordination instrument that attempts to align the interests of an agent to those of a principal. The economic analysis of agency investigates how contracts can be written to align the interests of agents and their principals. Given that altruism is limited, what makes it in the agent's self-interest to work towards the principal's best self-interest? Economists argue that decentralized market price systems align social interests with self-interested actions of individuals - the argument of the 'invisible hand'. The rationale for the existence of firms is to take economic transactions off the market and to substitute other control mechanisms in their place - the firm. The central idea in economics is that people must see the full costs and benefits of their

actions to perfectly align self-interest with social interest. Government involvement is justified in correcting market failures (Sherwin & Weinberg, 1998).

Figure 4.1: Markets and Organizations:  
A Conceptual Framework



Source: Adopted from Douma and Schreuder (1991) *Economic Approaches to Organization, Chapter One*

## Agency Theory, Ownership and Control

Two major forms of business organization are the entrepreneurial firm and the public corporation. The *entrepreneurial firm* is a firm owned and managed by the same person while the *public corporation* (not necessarily a state-owned enterprise) is a corporation with publicly traded shares and widely dispersed ownership. In the entrepreneurial firm there is no separation of ownership and control, while in the public corporation there is separation. Berle and Means (1932) cited in Douma and Schreuder (1991) describe separation of ownership and control in large corporations owned by many shareholders as a situation in which no single shareholder owns a significant fraction of the outstanding stock as to be able to control the actions of the officers of the corporation (managers). The managers themselves also own a very small part or nothing in the stock of the corporation. The situation may be characterized as follows:

- The bulk of profit goes to outside shareholders.
- All the major decisions are taken by the managers.
- The outside shareholders are unable to control the managers.

The basic argument in the ownership debate is that in the state-owned enterprises and large private corporations alike, ownership is divorced from management and hence principal-agent relationship and inherent problems are relevant. Managers (agents) of both organizations are likely to maximize objectives different from, and often incompatible with profit maximization - the principal's objective. But the deviation from profit maximization is likely to be more substantial in state-owned enterprises than in their private counterparts (Galal, 1990 cited in Nkya, 1995) because, at least theoretically, the non-profit activities of the private sector are "constrained by the potential sanction of takeover which is the principal means by which the capital market can exert pressure" on the sector (Cook and Kirkpatrick, 1988:13).

In this situation, Berle and Means (ibid) argue that the *interests of managers and shareholders diverge* widely. The managers are in search of *power, prestige and money* for themselves, while the shareholders are interested only in *profits*. Public corporations (not state-owned enterprises) in which managers own a significant part of stock are described as "owner-controlled" while those with widely dispersed share-holding can be described as "manager-controlled". Berle and Means theoretical argument predicts that owner-controlled companies should be more profitable than the manager-controlled companies. Empirical inquiry so far has not, however, supported this prediction. A relevant question, therefore, is:

*Why do managers of manager-controlled companies perform as well as managers of owner-controlled companies? If they have the opportunity to enrich themselves at the expense of shareholders, why do they not do so? Is it only because of ethical or moral considerations?*

According to Douma and Schrouder (1991), the following three potential market mechanisms prevent managers as agents, from acting against the interests of the shareholders as principals.

### *The stock market and the market for corporate control*

If a company performs badly, because the managers are incompetent, lazy or not interested in running the company, the market price of that company's stock (shares) will decline. If it becomes clear why the market value is falling, an outsider will try to acquire (takeover) the company at a low price, then throw out the management and install a better one. Therefore, managers who perform poorly must always fear their company can be taken over and themselves be thrown out. There is hence a market not only for individual shares, but also for whole companies. That is, there is a market to manage companies - the market for corporate control. Competition between management teams in the market for corporate control increases the pressure on managers not to perform poorly.

### *Market for managerial labour*

The top position in a large company usually gives a manager more power, more prestige, more money and more job satisfaction than the top position in a smaller company. We therefore expect some competition between managers to obtain those few top positions in the largest firms. So every manager has to worry about his reputation. If he acquires a reputation for pursuing his own personal interests instead of actively pursuing profit opportunities, it is likely that his chances of getting a better position are small.

### *Market for the company's products*

The more intense the competition in those markets is, the less opportunity there is for managers to pursue their own interests. If they do so the company will have higher unit costs than its competitors or turn out lower quality products. It will lose market share and ultimately cease to exist. Competition in the product market, therefore, restricts managers from pursuing personal self-interest at the expense of the company's profits - the owners' interest.

Even if the managers of a company do not own shares of their company, their pay package may still include bonus related to annual profits. This also brings the interests of managers more in line with those of the shareholders.

The role of *reward structure* is the key issue in the principal-agent theory. The principal's problem is to design the agent's reward structure in various *information* situations (certainty or uncertainty) and thus introduce the element of *risk*. A crucial question is how the principal can observe the agent's behaviour. Three cases can be distinguished in relation to the information status:

- The principal can observe the agent's behaviour (there is symmetric information).
- The principal has no information about the agent's behaviour (there is asymmetric information, the agent knows his level of effort but the principal does not. It is the agent who has *private information* about the level of effort).
- The principal cannot observe the agent's behaviour directly, but s/he can obtain a signal concerning the level of effort by the agent (see Douma and Schreuder, 1991).

The central issue in the principal-agent theory, therefore is, how in a world of uncertainty, information asymmetry and insufficient trust, could the principal design the agent's reward structure such that the agent works towards realization of principal's goals?

### Conclusion

Agency theory has been employed to compare managerial performance in private and public sectors and argues that ownership may not make much difference in performance. The central issue in the principal-agent theory is how in a world of uncertainty, information asymmetry and insufficient trust, could the principal design the agent's reward structure such that the agent works towards realization of principal's goals?

What may be more important is the ability of the principal to design an appropriate reward structure for the agent to deliver requisite benefits. It is also argued that rebalancing public-private sector relationship requires appropriate institutional framework that creates viable free market economy conditions. Three potential market mechanisms were found necessary to prevent managers as agents from acting against the interests of the shareholders as principals. They are market for corporate control, market for managerial labour, and market for the company's products.

The following chapter discusses the increasingly important concept of public-private partnership as an important strategy for broad privatization, particularly in terms of its political viability.

### Discussion Issues

1. *If ownership may not be so important in determining performance of large public enterprises, why do managers of state-owned enterprises in Tanzania perform poorly?*
2. *Under what conditions will privatization enhance performance of state-owned enterprises in Tanzania?*
3. *Besides ethical or moral considerations, why do managers of manager-controlled companies (public corporations with publicly traded shares and widely dispersed ownership) perform as well as managers of owner-controlled companies?*
4. *Why do managers of Tanzanian state-owned enterprises, which are also public corporations, perform less effectively and inefficiently than private enterprises?*

Public-Private Partnership for Economic Development

The Setting

Public-Private Partnership (PPP) is one of the important strategies of broad privatization, particularly in terms of its political viability. Unlike the other strategies and modalities of privatization, in the PPP the significance of the private sector is relatively less visible to the public political scrutiny. The private sector is viewed more as a 'partner' who augments public sector effort without transferring ownership of public enterprises. In a broader context of governance, PPP involves shared responsibility to achieve win-win outcomes for improving welfare.

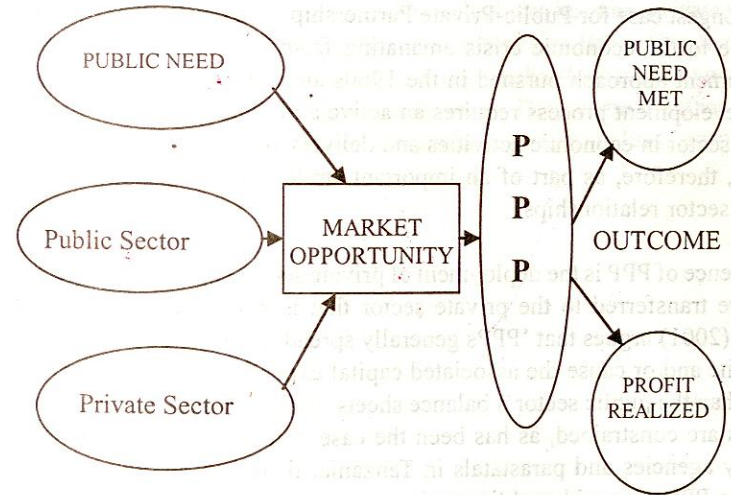
The purpose of this chapter is to present theoretical and practical elements of the PPP, and assess their feasibility from the public and private sector perspectives. The framework of analysis presented is based on the argument that performance of the PPP depends to a large extent on the nature of institutional arrangements or "rules of the game" governing the PPP. The main argument is that in many less developed countries PPP is politically more palatable than the outright transfer of ownership and control of production of goods and services. In exception of the outright transfer of ownership, most of the modalities of privatization are in essence PPPs.

The Concept and Scope of Public-Private Partnership

The current focus on the PPSR is to forge Public-Private Partnership (PPP) in production and delivery of public goods and services. PPP is constituted when the private sector works with the public sector to attract private sector resources (capital and/or expertise) in order to provide and deliver public goods. Gerard (2001) views PPP as a business relationship between the public and private sectors in which private sector resources are deployed to improve public services or management of public sector assets. Philosophically, it is a shift away from the past belief or doctrine that either the public or the private sector was the only best way to serve the public. PPP is defined as "combining of a public need with private capability and resources to create a market opportunity through which the public need is met and a profit is made" (Heilman & Johnson, 1992). PPPs share a common objective, that is, to create or enhance a market opportunity for the efficient

production or delivery of a public good or service. They are intended to increase the role of the private sector in production or delivery of public goods or services. The process towards PPP is what Bouin and Michalet (1991) call "rebalancing" the public and private sectors. The government moves from the direct production of private goods and allows the increased role of the private sector through various forms of PPP. According to Koldirie (1986 cited in Nkya, 1995), PPP involves a "reconfiguration of organizational structures and relationships between the sectors so as to provide, produce, or deliver a service" where both partners realize a benefit. The PPP concept is depicted in figure 5.1 below.

Figure 5.1: Public-Private Partnership Concept



Source: Developed from literature review

There are diverse views as to whether the sale of state-owned enterprises and public sector assets (divestiture) could be viewed as a form of PPP. From a macroeconomic perspective, if the economy is viewed as comprised of the private and public spheres of activity, it is plausible to think of PPP as a form of the broad concept of privatisation in which provision of public goods moves partially into the private sector sphere. PPP is manifested because the private sector produces/ supplies and the public sector provides an enabling environment for the private sector to produce. Gerard (2001) argues, however, against identifying PPP with

“privatisation” in which market forces dictate the performance of privatised entities. It is argued that a PPP is a business relationship between the public and private sectors that is defined by a long-term contract in which public services to be delivered by the PPP (the outputs) are specified in great detail. The scope of PPP operations, and its potential for profit, is constrained contractually rather than by market forces or the intervention of a statutory regulator. Normal private sector incentives for management still apply within a PPP, such as the need to earn an adequate return on capital, but the business is, in effect, “passively regulated” by virtue of the constraints placed upon it contractually and without the intervention of a regulator (Gerard, 2001:49).

### **Rationale for Public- Private Partnership**

The strongest case for Public-Private Partnership (PPP) is built on the need for a response to the economic crisis emanating from excesses of the state-centred development approach pursued in the 1960s and 1970s as discussed in chapter two. Development process requires an active and deliberate involvement of the private sector in economic activities and delivery of services. PPP initiatives are viewed, therefore, as part of an important strategy for rebalancing the public-private sector relationships.

The essence of PPP is the deployment of private sector capital where performance risks are transferred to the private sector that is better placed to assess them. Gerard (2001) argues that ‘PPPs generally spread the costs of procuring an asset over time and/or cause the associated capital expenditure to affect private firms rather than the public sector’s balance sheets’ (p50). Where public sector capital budgets are constrained, as has been the case with the undercapitalised service delivery agencies and parastatals in Tanzania, there are obvious advantages in adopting PPP to provide public services.

The motivation for making greater use of PPP is to obtain increased value for money in the provision of public services because the private sector is more likely to make the right commercial decisions about design, operating regime, human resource planning, whole-life-of-asset costing, and risk assessment (Gerard, 2001).

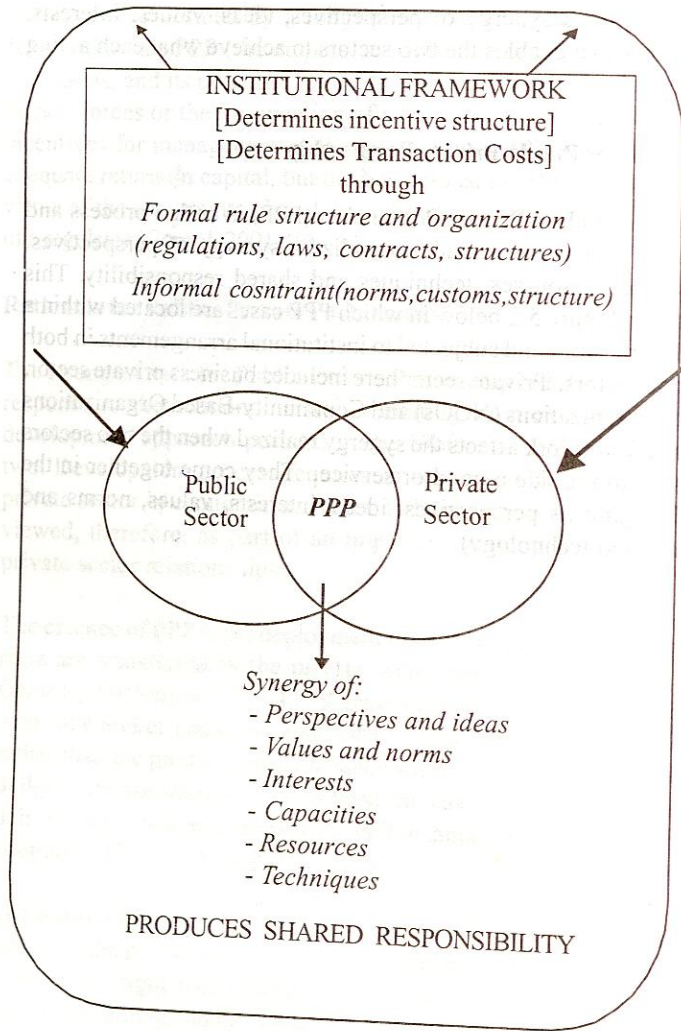
The political economy of rebalancing the public-private sector relationships discussed in chapter eight shows that PPP is also a strategy for placating political resistance against privatisation of public assets and provision of services. As Gerard (2001) puts it ‘PPPs operate at the boundary of the public and private

sectors, being neither nationalized nor privatized assets nor services. Thus, politically, they represent a third way in which governments may deliver some public services’. The framework of analysis presented in Figure 5.2 below shows also that PPP provides for a synergy of perspectives, ideas, values, interests, capacities and resources that enables the two sectors to achieve what each acting alone cannot.

### **Framework of Analysis for Public-Private Partnership**

Nkya (2000) argues that Public-Private Partnership (PPP) is both a process and structure in which an endeavour is made to realize a synergy of perspectives, ideas, values, capacities, resources, techniques and shared responsibility. This argument is depicted in Figure 5.2 below in which PPP cases are located within a macro institutional framework and subjected to institutional arrangements in both the public and private sectors. Private sector here includes business private sector, Non-Governmental Organizations (NGOs) and Community-Based Organizations (CBOs). Institutional framework affects the synergy realized when the two sectors enter into partnership to provide a good or service. They come together in the partnership each bringing its perspectives, ideas, interests, values, norms and capacities (resources and technology).

Figure 5.2 Public-Private Partnership: Location and Context



Source: Nkya, E.J. (2000):p15

The institutional framework depicted in Figure 5.2 determines incentive structure and levels of transaction costs of the PPP. Institutions are a set of constraints (rule and norm structure), which govern the behavioural relations among individuals or groups. Institutions embody rules, norms, enforcement mechanisms and organizations. Institutions structure incentives in human exchange, whether political, social or economic.

Transaction costs are the costs of finding what the relevant prices are (information costs), negotiating and concluding contracts, and monitoring and enforcing contract in economic organization. Institutions are transaction cost-minimizing arrangements, which may change and evolve with changes in the nature and sources of transaction costs and the means of minimizing them. The most basic function of institutions is to economize.

Transaction costs embodied in particular institutional arrangements influence the configuration of a particular PPP; whether a concession, a joint venture or variations in between the two forms.

### Forms and Characteristics of Public-Private Partnership

Two broad forms of Public-Private Partnership (PPP) have been identified: *concession* contract and *equity joint venture*. In between these two forms there is a wide spectrum or continuum of PPP possibilities extending from forms almost entirely controlled by the private sector, at one end, to those almost entirely controlled by the public sector, at the other. In the concession-based PPP, the operations are defined by a long-term contract in which public services to be delivered by the PPP (outputs) are specified in great detail. In an equity joint venture between public and private sectors, the PPP assumes specified public sector obligations set out in its documents of partnership. In the concession-based PPP, on the other hand, the public sector pays for services on behalf of the general public and retains ultimate responsibility for their delivery, whereas the private sector's role is limited to that of providing an improved delivery mechanism for the services (Gerard, 2001).

The essential role of the public sector in all forms of the PPP is to define the scope of business which entails specification of priorities, targets, outputs and setting performance regime which provides incentives for the management of the PPP to perform. In the case of the concession-based PPP the public sector pays for the services provided. The essential role and responsibility of the private sector in all

PPPs is to deliver the business objectives of the PPP in terms offering value for money to the public sector.

Between these two forms of PPP, various partnership regimes offer possibilities of adaptability to specific needs and context of the public sector. Where the scope of future service delivery cannot be fully defined at the outset, joint-venture is more appropriate. Where output can be well defined and specified, concession contract may be required. Alternatively, a public sector authority may hold a minority equity stake in a PPP to share in the profits generated by the operations which are managed by a strategic investor.

Table 5.1 below presents 'institutional organizational forms' (Batley calls them 'institutional arrangements') of combining public and private actors (Public-Private Sector Partnership) in services provision and production. Each PPP form is 'appropriate under particular circumstances and each implies a different role for the public sector, whether as direct deliverer or as licensor, contract maker, regulator, sub-contractor, enabler, financier, partner, subsidizer or as arbitrator between users' (Batley, 1994:9).

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Table 5.1: Institutional Forms ('arrangements') and Appropriateness to Service

INSTITUTIONAL FORMS	FACTORS FAVOURING THE FORM	EXAMPLES OF APPROPRIATE SERVICES
<p><i>Pure State Supply</i></p> <ul style="list-style-type: none"> <li>Govt assumes full responsibility for all aspects of supply (although sub-contracting is possible)</li> </ul>	Public goods and services with a tendency to monopoly, large scale and high externalities	Water, sewerage, solid waste treatment, mass health education
<p><i>Community Supply</i></p> <ul style="list-style-type: none"> <li>Community or neighbourhood takes full responsibility for supply</li> </ul>	Public goods and services of small scale and limited externalities beyond community	Neighbourhood improvements, community level water and drainage, local roads
<p><i>Licensed Private Supply</i></p> <ul style="list-style-type: none"> <li>Govt takes minimal role in licensing private suppliers</li> </ul>	Private goods and service with low externalities	Taxis, markets, public Transport, food retail
<p><i>Govt Responsibility and Property with Private Production</i></p> <ul style="list-style-type: none"> <li>Govt pays private                             <ul style="list-style-type: none"> <li>- works contractor</li> <li>- service or management contractor for up to 5 years to undertake specific operations and maintenance</li> </ul> </li> </ul>	Public goods and services. Contracting presupposes divisibility of the production process and capacity of government to control contractors	Public works, maintenance of works and equipment, aspects of administration computing, legal or accounting services etc)
<p><i>Govt Ultimately Responsible but Operative Responsibility Transferred to Private Production</i></p> <ul style="list-style-type: none"> <li>Lease contracts for around 10 years. The leaseholder assumes responsibility for the financing of maintenance</li> <li>Concessions or Franchise for around 20 years Contractor finances investment and maintenance</li> </ul>	Presupposes excludability; the capacity of firms to finance investment and to tolerate risk; the capacity of government to supervise contract compliance	Water supply, gas, markets, public transport

<p><b>Partnership Between Public and Private Suppliers (PPP)</b></p> <ul style="list-style-type: none"> <li>• Joint ownership</li> <li>• Joint investment</li> <li>• Joint ventures in which the distinct roles of public and private sectors are combined</li> </ul>	<p>Where there is mutual interest in projects which offer the possibility of return on investment; the private sector needs government to cover risks or make basic investment the public sector hopes for public benefits from private investments.</p>	<p>Acquisition and development of land for residential and business development</p>
<p><b>Public Subsidy for Private Consumption</b></p> <ul style="list-style-type: none"> <li>• Govt subsidises (grants) the consumer to enable purchase of private goods and services, such as</li> <li>• Vouchers allowing beneficiaries to choose between deliverers</li> <li>• Tax waivers</li> </ul>	<p>Where increase in consumption of private goods brings external benefits and private provision is more efficient</p>	<p>Food, housing, education, curative health services</p>
<p><b>User Control of Public Supply</b></p> <p>The user participates in the management of goods and services</p>	<p>Public goods and services of small scale and without strong divisions of interests between users</p>	<p>Neighbourhood improvement, community water and drainage, local roads and schools</p>
<p><b>Public Supply with market Processes</b></p> <p>Charging for services received</p>	<p>Goods and services which have private characteristics, where consumption can be related to capacity to pay and there are important redistributive considerations</p>	<p>Land, housing, public transport, metered water and energy</p>

Source: Batley (1994) "The Role of Government in Adjusting Economies" pg.11

## Conditions for Public-Private Partnership Success

A successful Public-Private Partnership (PPP) requires institutional, policy and attitudinal reforms by both the public and the private sectors in order to create an enabling environment. For the public sector, reforms would typically include a move from "input" to "output-based" contracting, which may require significant investment in developing skills and guidance on best practices. It will also require enactment of enabling legislation to overcome issues related to public sector legal authority and taxation of PPP concession contracts. Institutional reform will also be required to assist in prioritising, providing resources and approving transactions. For the private sector, reforms may be required to build capacity in the provision of integrated whole-life-of-asset-based services to the public sector and to provide long-term finance. The rules by which a PPP operates must be clearly articulated within its contractual arrangements, so that the management team knows the constraints within which it must operate (Gerard, 2001).

A related problem for public policy that determines success or failure is how to organize and manage a PPP so as to maximize its advantages while minimizing risks - in effect combining economic efficiency and political accountability. The challenge for policy science is to define, assess, and respond to the tensions, risks, and conflicts of values inherent in PPP. The issues involved are both theoretical and practical. A theoretical concern is the impact of the PPP on the system of governance and vice versa. At a *practical level* the issue is what strategies public managers might adopt to balance economic and political values in PPP. How can a PPP balance or join the different values inherent in the private and public markets? The fundamental private market value is *profit* which is driven in part by efficiency and market competition (Heilman and Johnson, 1992:17).

The public market, on the other hand, is based on the values of *representativeness* and *public accountability*. Public accountability results, in part, from open and cooperative processes of information sharing and decision-making. Such processes include public notice, public meeting, and voting. Thus, the fundamental dynamic of each market is in conflict with one another. The problem for PPP, therefore, is how to resolve or accommodate this conflict (Heilman and Johnson, 1992:17).

Success or failure will also depend on the value that a private sector investor seeks from a PPP, which is a return on its capital employed. The public sector, by contrast, will apply a much wider concept of value to its participation as an investor in a PPP than simply the return on its capital employed, which would include public policy effectiveness and public accountability.

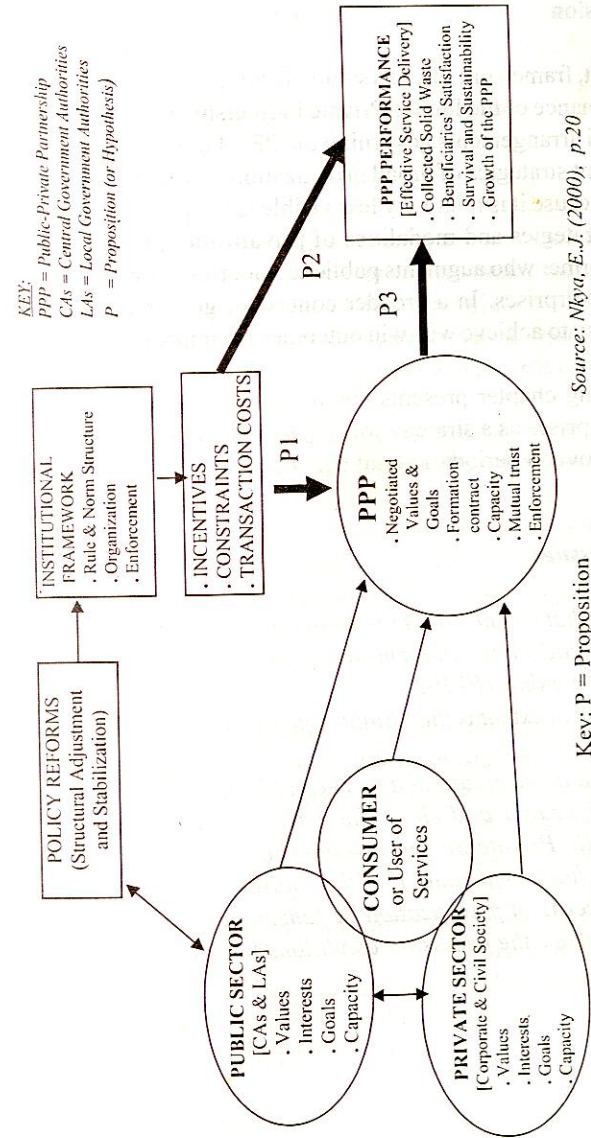
## Empirical Study of Public-Private Partnership

An empirical study carried out in year 2000 analysed six cases of Public-Private Partnership (PPP) between the Dar-es-Salaam City Commission and private companies including Non-Governmental Organizations. The focus of the study was on the role of institutional arrangements in the success or failure of PPPs in solid waste management in Dar-es-Salaam. The frame of analysis for the study argues that PPP is part of policy reforms, and performance of the PPP in terms of effective solid waste collection is a function of institutional arrangements (norm, rule structure and organization including contact) and their enforcement (Nkya, 2000).

Three propositions were tested using qualitative data, and it was found that incentives, constraints and transaction costs inherent in institutional arrangements shape formation and capacity of Public-Private Partnership in solid waste management. An institutional framework that provides for a clear assignment of rights, responsibilities and obligations in a climate of mutual trust and fair business practices motivates partners, reduces constraints, lowers transaction costs and enhances growth and sustainability of the PPP (Nkya, 2000).

It was further found that negotiated values and goals in the PPP contract influenced effectiveness of the PPP in terms of survival, sustainability and growth. Mutually acceptable, achievable and viable goals of Public-Private Partnership simplified enforcement, raised level of effectiveness and enhanced sustainability and growth of the PPP in solid waste management (Nkya, 2000). The above descriptive analysis is given in figure 5.3 below.

Figure 5.3: Framework of Analysis for Public-Private Partnership in Solid Waste Management in Dar-es-Salaam



## Conclusion

The concept, framework of analysis and forms presented are based on the argument that performance of the Public-Private Partnership (PPP) depends on the nature of institutional arrangements governing the PPP. Public-Private Partnership is one of the important strategies of broad privatization, particularly in terms of its political viability, because it is relatively less visible to the public political scrutiny. Unlike the other strategies and modalities of privatization, the private sector is viewed more as a partner who augments public sector effort without transferring ownership of public enterprises. In a broader context of governance, PPP involves shared responsibility to achieve win-win outcomes for improving welfare.

The following chapter presents empirical analysis of privatization of the state-owned enterprises as a strategy for rebalancing public-private sector relationship in Tanzania over a period of about ten years.

## Discussion Issues

1. To what extent would the values of the private and public sector markets contradict to undermine optimal performance of Public-Private Partnership (PPP)?
2. To what extent is the "Build, Operate and Transfer" form of privatisation a PPP?
3. What is the nature and essence of PPP? Discuss two real cases of PPPs in Tanzania and show the extent to which they are rebalancing the Public-Private Sector Relationship.
4. To what extent could the PPP address favourably the political economy concerns of privatization in Tanzania?
5. What are the necessary conditions for successful PPPs?

## CHAPTER SIX

### Privatization Policy and Process in Tanzania

#### The Setting

The ongoing privatization of the state-owned enterprises and social services in Tanzania, which started in 1992, is instrumental for demonstrating the effectiveness of broad privatization in tilting the public-private sector relationship in favour of the private sector. In order to get an insight of the public-private sector relationship it is important to understand the institutional framework and process of privatization.

The purpose of this chapter is to examine the Tanzanian case of 'broad' privatization with a focus on institutional framework and process that is effectively rebalancing the public-private sector relationship in Tanzania. After several years of state-centred development in Tanzania with heavy dependence on the public sector in almost all development activities, privatization is viewed as the main strategy for changing the public-private sectors relationship in favour of the private sector.

#### Institutional Framework

The basic policy and institutional framework for privatization was instituted by the Public Corporations Act No.2 of 1992 which also established the Parastatal Sector Reform Commission (PSRC). The commission is entrusted with overseeing the making and implementations of the "secondary" (operational) privatization policies and restructuring the state-owned enterprises. The choice of forms of privatization as policy instruments fall under the "secondary or operational" policy as distinguished from "principal or basic" policy defined in the Government Circular No.1 of 1984. Basic or principal policy is defined as high level political decisions that seek major structural changes in society while secondary or operational policy involves substantive matters of policy which are the responsibilities of sectoral ministries and other government agencies (Mukandalla and Shellukindo, 1994 cited in Nkya, 1995).

Responsibilities of the PSRC are provided for in Section 22(2) of the Act No.2 (1992), inter alia, as to:

- (a) develop operating policies, procedures and guidelines for the implementation of the public corporation restructuring reforms decided by the Government [basic policy], and, [...]

(b) review and make recommendations on specific policies and legislation pertaining to the public corporations sector (URT, 1993a:170).

It is important to note that the PSRC is expected to oversee or coordinate the making of operational policies. The actual policies such as choice of forms of privatization are to be formulated by the state-owned enterprises' sectoral (parent) ministries and approved by government (Cabinet). Section 22(3) of the Act makes the following specific provisions in that regard:

*The Commission shall not enter into any agreement or other transaction relating to the value, sale or disposal of any public corporation shares or assets of a public corporation without consultations in writing with the Treasury, the responsible [parent] Minister and Attorney General [...]. If, having received the views of the parties to be consulted, the Commission intends to take a contrary decision, inform the parties and the President in writing [...]. Any decision of the President on any information submitted by the Commission shall be final (URT, 1993a:170 cited in Nkya, 1995).*

### Privatisation Process

The above legal provisions have been operationalized by the Parastatal Sector Reform Commission (PSRC) in their 1993 'Parastatal Privatization and Reform Master Plan', into a three-stage process which refers to the privatization function of the PSRC (not the restructuring function) (URT, 1993b). *Stage one* involves the choice of forms or modalities of privatization. It involves the assessment of the feasibility of privatizing each state-owned enterprise and to determine the most appropriate modality including trade sales, joint ventures, public share offers, public auction, private placement, management and employee buy-outs, liquidation, leasing, management contracts, debt-equity swaps, and 'golden share' option.

In a 'golden share' option the government holds one share with specific powers to limit the decisions of the major share holder/s in areas considered of strategic or national interest by the government. Decisions in which the golden share option could be applied include voluntary winding up, disposal of assets, control of appointments of directors and change of core activities of the enterprise.

*Stage two* involves 'execution' in terms of preparing the state-owned enterprise for privatization. It includes the diagnosis of the state-owned enterprise's performance history, corporate structure, employment profile and valuation. The *third and final stage* is implementation which is a continuation of execution. Activities at this stage depend on the modality of privatization chosen in stage one. It includes preparation of sale memoranda or prospectus (in the case of divestment), advertising and inviting bids or proposals against predetermined selection criteria, negotiation, obtaining final government approval (in the case of divestment), preparation of contractual documents, and conclusion of the deal (signing).

The above process is carried out for each case of privatization through two major committees coordinated by the PSRC. After a state-owned enterprise has been 'specified' for privatization by Ministerial Orders published in the Government Gazette, a PSRC-led Divestiture Task Force (DTF) is formed for that particular enterprise. The DTF is comprised of representatives from the state-owned enterprise's parent ministry, and the holding corporation, the Attorney General's office, the Treasury, and state-owned enterprise's management. The PSRC has to approve every stage of the Task Force proceedings. The sectoral ministries with the largest number of state-owned enterprises - the Ministry of Industries and Trade (MIT) and the Ministry of Agriculture (MOA) - have set up their own privatization units which are supposed to follow the PSRC procedure.

Within the PSRC itself, which is organized into sectoral departments (see appendix A5), a Divestiture Technical Support Committee (DTSC) is formed for each case of privatization. The functions of the DTSC are to analyze the outcomes of the DTF proposals and prepare briefs for negotiations and other execution activities. Details of the actual process and actors involved differ with each case of privatization.

In stage one above the PSRC and the sectoral ministries implement the basic policy framework by making operational policies. The implementation of operational policies involves execution activities in stages two and three of the PSRC process. In this process, for example, negotiations for a privatization deal would not normally determine the modality of privatization because it is already predetermined in stage one.

The entire process is guided by specific *principles of privatization*, which have also influenced the choice of modalities of privatization (URT, 1993b). The first principle, is the need for transparency of the process in terms of open (publicized) information about the financial position of state-owned enterprises to be privatized, bidding procedures, criteria for the evaluation of bids, the locus of responsibility for decisions and outcomes.

The *second* principle is the protection of national interest through 'ownership policies and practices that preserve the gains achieved over the past 25 years through widening both the indigenous ownership and management opportunities, while strengthening the contribution of foreign investors and joint venture partners to enterprise success' (URT, 1993b:9 cited in Nkya, 1995).

The *Third*, is the protection of consumers' interests through a regulatory legislation to penalize restrictive trade practices such as price fixing or restricting the entry of new firms to an industry.

The *fourth* principle is in regard to 'safety net' for losers in the privatization process. Those individuals who have to lose their jobs in the process of privatization or restructuring are entitled to statutory benefits, supplementary compensation and opportunities for redeployment.

The *fifth* principle is about debts of the state-owned enterprises to be privatized. A case by case basis is adopted to cancel the debts or convert them into equity at a discount.

### Valuation of State-Owned Enterprises and Assets

Valuation of assets is another policy aspect in which the Parastatal Sector Reform Commission (PSRC) has to ensure that a state-owned enterprise is assessed prior to inviting bids. Four alternative methods of valuation considered are:

- **Liquidating value:** The amount that could be realized if an asset or a group of assets were sold separately from the organization that had been using them. If you subtract debts or liabilities from the accounting value of a firm, you get liquidating value of ownership.
- **Going concern value:** Firm sold as an operating business. Going concern value minus liquidating value = 'good will' (value of organization distinct from the value of assets. It arises from the historical performance and name of the firm).
- **Book value:** Accounting value at which an asset is carried.
- **Market value:** Price at which the asset can be sold in a free market. If a firm has two market values (liquidating and going concern value) the higher of the two is referred to as the market value.

Broad criteria have also been laid down to guide privatization in general. Commercial state-owned enterprises which are expected to operate at a profit will become available for foreign and local participation. This implies joint venture. Those commercial enterprises which cannot be operated profitably and cannot attract private sector

participation will be closed down and liquidated. Some state-owned enterprises may be restructured prior to privatization and, according to the Government Circular No. 1 of 1992, the public holding corporations will be restructured into state-owned consultancy, research and development organizations to serve the remaining state-owned enterprises at a fee, and also advise the government on the joint venture enterprises (URT, 1992a; URT, 1993b cited in Nkya, 1995).

Policy making process requires also that a broader evaluation of rebalancing public and private sector relationship be carried out to assess the overall impact of privatization. The evaluation is undertaken on the basis of the following policy evaluation criteria (See Table 6.1).

Table 6.1: Evaluation Criteria

CRITERION	QUESTION	OPERATIONAL CRITERIA
EFFECTIVENESS	Has a valued outcome been achieved? To what extent have objectives been achieved?	Units of output/services compared with objectives or targets
EFFICIENCY	How much effort was required to achieve a unit of valued outcome?	Unit Cost Net Benefits Cost-Benefit Ratio
ADEQUACY	To what extent does the achievement of a valued outcome resolve the problem?	Adequacy/sufficiency of resources and objective given size of the problem
EQUITY	Are costs and benefits distributed equitably among different groups/stakeholders?	Pareto Criterion Kaldor-Hicks Criterion Rawls Criterion ( <i>see below</i> )
RESPONSIVENESS	Do policy outcomes satisfy the needs, preferences or values of particular groups/stakeholders?	Consistency with citizen survey of needs
APPROPRIATENESS	Are desired outcomes (objectives) actually worthy or valuable? Is it "right" (in terms of values) to pursue those strategies and objectives?	Public Programs should be equitable as well as efficient

Source: Dunn, W.N. (1981:343 and Craig, D.P. (1978)

The equity criterion in table 6.1 is elaborated below.

#### Kaldor-Hicks Criterion

A criterion of equity which states that one social state is better than another if there is a net gain in efficiency (total benefits minus total costs) and if those who gain can compensate losers.

#### Rawls Criterion

A criterion of equity which states that one social state is better than another if it results in a gain in welfare for members of a society who are worse off.

#### Pareto Criterion

A criterion of equity which states that one social state is better than another if at least one person is better off, and no one is worse off. A *Pareto Optimum* is a social state where it is not possible to make any person better off without also making another person worse off (Dunn, 1981).

Table 6.2: Performance Summary of the Parastatal Sector Reform Programme as at June 2003

Description of status	Companies	Units	Remarks
Completed Divestitures at Sale Agreement Stage	155	192	All have been approved by Cabinet and handed over to investors
Completed Divestitures at Memorandum of Understanding Stage	32	39	Either cabinet approval or payment by investor awaited before signing Sale agreement and hand over of assets to investors
<b>Total Completed by PSRC as at 30 June 2003</b>	<b>187</b>	<b>231</b>	
Complete under LART	50	50	These represent parastatals sent to LART for liquidation.
<b>Total Completed Divestitures as at June 30, 2003</b>	<b>237</b>	<b>281</b>	PSRC's level of effort is measured by counting all those which have gone through the Memorandum of Understanding stage and handed over to LART, as completed
Uncompleted Divestitures as at June 30, 2003	47	70	Parastatals at this stage are mostly agricultural undertakings
<b>Total Number of Parastatals for Divestiture as at 30 June 2003</b>	<b>284</b>	<b>351</b>	These total figures represent parastatals available for divestiture
Non-C.G.C. Assets Disposed of, as at June 30, 2003		271	These represent physical assets, mainly property, considered non-core to the main assets of the parastatals divested
Public Corporations Acquired by Tanzania Investors as at 30 <sup>th</sup> June, 2003		140	These represent companies acquired by Tanzania Investors 100%
Public Corporations Acquired by Foreign Investors as at 30 <sup>th</sup> June, 2003		20	These represent companies by Foreign Investors 100%

Source: URT (2003) "Privatisation in Tanzania: Annual Review 2002/2003 and Action Plan 2003/2004" Dar es Salaam, pg 12.  
A document of the Presidential Parastatal Sector Reform Commission (PSRC)

Table 6.3: Distribution of Modalities of Privatization by Phase of Reforms in Tanzania (number of firms): 1980-2003

PHASE MODALITY	1980-85 (NESP/SAP)	1986-89 (ERP)	1990-92 (ESAP)	1992-2003* (PSRC)	TOTAL
DIVESTMENT	0	0	5	219	224 (50%)
DELEGATION	15	5	9	23	52 (12%)
DISPLACEMENT	4	13	41	109	167 (38%)
<b>TOTAL</b>	<b>19</b> (4%)	<b>18</b> (4%)	<b>55</b> (13%)	<b>351</b> (79%)	<b>443</b> (100%)

\* The period covers the establishment of the PSRC, more vigorous privatization policy of the Third Phase Government from 1995 and Poverty Reduction Strategy from 2000. Some cases in the period may also include some cases from previous period because of overlap of financial and calendar years.

SOURCE: Computed from: Parastatal Privatization and Reform Master Plan, 1993; PSRC 1993 Review; PSRC Action Plan (1994/95); PSRC Annual Review 2002/03 and Action Plan 2003/04; World Bank (1987); Government statements and interviews.

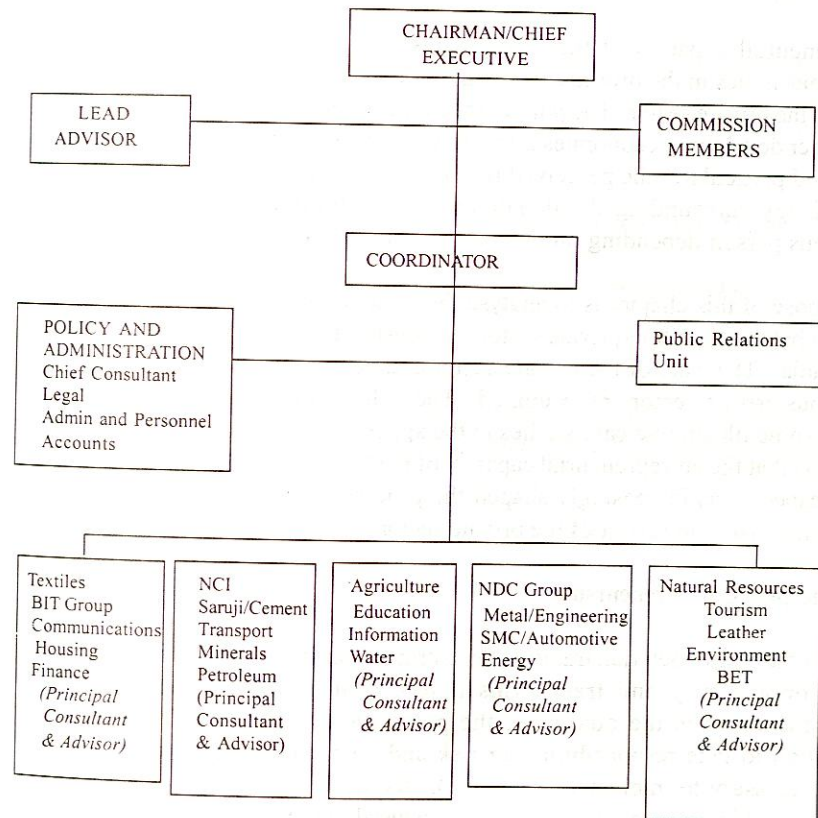
KEY:  
 NESP = National Economic Survival Program  
 SAP = Structural Adjustment Program  
 ERP = Economic Recovery Program  
 ESAP = Economic and Social Action Program.  
 PSRC = Parastatal Sector Reform Commission, DSM, Tanzania.

### Conclusion

Institutional framework governing privatization of the state-owned enterprises and social services in Tanzania is based on the legislation enacted in 1992. The ongoing privatization demonstrates the effectiveness of broad privatization in tilting the public-private sector relationship in favour of the private sector. After several years of state-centred development in Tanzania, with heavy dependence on the public sector in almost all development activities, privatization is viewed as a response to the economic crisis caused by poor public sector performance in the 1970s and 1980s. A clear privatization policy and an independent implementation organization have been able to cope with the political economy constraints to privatization and cut across deep vested interests.

Figure 6.1

### ORGANIZATION STRUCTURE OF THE PARASTATAL SECTOR REFORM COMMISSION (PSRC)



Source: Parastatal Sector Reform Commission, Dar es Salaam

**Indigenization Debate and Entrepreneurial Capacity in Tanzania**

**The Setting**

Entrepreneurial capacity of the “indigenous” Tanzanians is one of the most contentious issues in the process of changing the public-private sector balance in favour of the private sector. The political economy of privatization in Tanzania and many other developing economies is to a large extent driven by the indigenization debate and particularly the perceived meaning of an indigenous person. Politics and ideology surrounding the debate are also redefining the concept of the indigenous person depending on the constituency addressed by a politician.

The purpose of this chapter is to analyse the issue of entrepreneurial capacity in light of rebalancing public-private sector relationship and the indigenization debate in Tanzania. The state of the private sector and policy measures to enhance the indigenous private sector are examined. The indigenization debate is examined through some illustrative case studies in the appendix. The main argument in the analysis is that the entrepreneurial capacity of the “indigenous” private sector and related aspects has increasingly shaped the process of tilting the public-private sector relationship in favour of the private sector.

**The Concept of Entrepreneurship**

Going by the Schumpeterian tradition, an entrepreneur is a person who identifies a market opportunity and transforms it into a profitable economic value. Entrepreneurship is the quality of the person which includes both attitude (disposition to take responsibility for risk and outcomes) and behavior (set of actions necessary to implement a venture). As Morris and Lewis (1995) show, entrepreneurship requires both an entrepreneurial event (conceptualization and implementation of a new venture) and an entrepreneurial agent (individual or group that assumes personal responsibility for bringing the event to fruition). Behavioral ingredients of entrepreneurship include innovation, risk-taking and pro-activeness which determine the degree (high or low) of entrepreneurship (Morris and Lewis, 1995:33).

Given the free market essence of economic reforms in Tanzania, an entrepreneurial event can be viewed as having the following characteristics given by Shapero and Sokol (1982 cited in Nkya, 1999):

- Initiative taking (by an individual or group).
- Consolidation of resources through formation or restructuring of an organization to accomplish some objective.
- Management of the organization by those who took the initiative.
- Relative autonomy in which resources are disposed of and distributed with relative freedom.
- Risk-taking in which the organization’s success or failure is assumed by the initiator/s.

**Effect of the State-Centred Development on the Indigenous Private Sector**

The capacity and role of the private sector in Tanzania was significantly dwindled by the state-centred development strategy adopted after the 1967 Arusha Declaration. As shown in table 7.1 below, the percentage share of the private sector in total monetary fixed capital formation decreased from about 56% in 1961 to about 23.9% in 1971, the period of massive nationalizations. The share of the private sector in investment started rising again in the 1980s as a result of the measures taken in the structural adjustment programs reaching almost 67% in 1991.

*Table 7.1: Private and Public Sector Percentage Shares in Total Monetary Fixed Capital Formation*

YEAR	1961	1971	1984	1989	1990	1991	2003
Private Sector	56.8	23.9	61.6	79.6	66.6	67.3	63.9
Public Sector	43.2	76.1	38.4	20.4	33.4	32.7	36.1

*Source: Bukuku (1993):151; Economic Survey (1992):25; Economic Survey (2003):26*

The effect of the state-centred development on the share of the private sector in formal employment manifested a similar trend. While in 1965 the private sector absorbed about 68% of the total labour force and state-owned enterprises only 5%, in 1981 the share of the private sector had fallen to 29%, picking-up again during the second half of the 1980s, reflecting the impact of the economic policy reforms (World Bank, 1989 and URT, 1989).

The above data for the private sector includes all economic activities, large and small. When the small scale economic activities and non-commercial activities are excluded, the remaining part of the private business sector is relatively small. The main commercial sectors (manufacturing, trade and commercial services) contributed, on average (1990-92), about 32% to Gross Domestic Product (at constant 1976 prices) with manufacturing, in which most of the state-owned enterprises referred to in this study are concentrated, contributing only about 8% (Nkya, 1995).

The main interest here, however, is the relative roles of the indigenous and non-indigenous entrepreneurs. Although data for the entire national industry was not available, data for Dar-es-Salaam, which is the major industrial centre in Tanzania, indicated that the medium and large commercial sector firms are dominated by the non-indigenous business community.

In a sample of 131 firms picked randomly from a 1989 World Bank industrial survey, only 54 firms (41%) were owned by indigenous entrepreneurs. In this sample about 35% of firms were of small size category (less than 10 employees). Of the 131 sample firms, 57 (about 43%) were owned by non-indigenous entrepreneurs (including foreign-owned) (see Table 7.2 below). The significance of this 43% owned by non-indigenous entrepreneurs should be viewed in the light of the fact that, the proportion of the non-indigenous population in total population was very small. At the national level, for example, the non-indigenous population accounted for only about 1.3% of the total Tanzanian population of 25 million: Asians (0.84%), Arabs (0.25%) and Europeans (0.17%) (Berg-Schlösser, 1992:73).

Table 7.2: Ownership Structure of Sample Enterprises in Dar-es-Salaam in 1989

Ownership	Indigenous	Non-Indigenous	Foreign	SOE**	Other	Cases
Number	54	45	12	10	10	131
Percentage	41.2	34.4	9.2	7.6	7.6	100
Percentage* of Total Population	98.7	1.3	NA	NA	NA	NA

Source: Adapted from M. Dutz and C. Frischtak (1993) *The Entrepreneur as Agent of Industrial Change*, in World Bank (1994:193), op.cit. Annex 16. (cited in Nkya 1995)

\*The population row is based on the 1988 census projections.

\*\*SOE = State-Owned Enterprises

It is necessary to bring out these representative structural characteristics of the private sector because the issue of who takes up ownership and control of the state-owned enterprises slated for privatization has been a major concern of the policy makers in Tanzania. It is in particular influencing the choice of modalities of privatization (Nkya, 1995).

Another related aspect is the *capacity of the indigenous private sector*. Information on the actual and potential capacity of this sector is scanty and qualitative only. The focus of the qualitative information available is mainly on how the various policies under the Arusha Declaration deliberately undermined and retarded the development of the indigenous entrepreneurs and inadvertently reinforced the then already favourable position of the non-indigenous entrepreneurs.

In 1994, for example, a government statement admitted negative effect of the previous state-centred development policies on the development of the indigenous private sector. Speaking at a function organized by the Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA) in Dar-es-Salaam, the Minister of Industry and Trade alluded to the past government neglect of the indigenous private sector when he reportedly stated that:

*Over the years there was no deliberate policy to involve indigenous persons in major business activities. Most parastatal managements were recruited from indigenous personnel. The private sector was beset by a lack of clearly defined plans, inadequate access to capital and shortage of management and technological skills (Business Times, August 26th, 1994:9).*

The "formal" constraints frequently mentioned in reference to the indigenous entrepreneurs include lack of entrepreneurial background and skills; lack of equity funds and limited access to credit; distortive macro-economic policies with inadequate incentive structures; high cost operating environment; restrictive regulations; weak legal and judicial system; inadequate public services (Mbowe, 1994; World Bank, 1994:46-47).

The above constraints, however, are a manifestation of more fundamental causes of a weak indigenous sector. Out of the 51 interviews conducted, 42 respondents singled out the Arusha Declaration and subsequent policies to have contributed significantly in retarding the development of the indigenous entrepreneurial capacity (Nkya, 1995).

The 1967 Nationalization Act not only crowded out the private business sector in general, but also cultivated an attitude among the indigenous people that, the state is capable of doing everything for them. And when later, in 1973, the policy was extended down to petty businesses like closing down privately owned butcheries and rural private shops, which were the seed-beds for entrepreneurship, it became even more difficult for the small-scale entrepreneurs to develop openly and legally. The proportion of "underground" or "subterranean" economy in Tanzania's Gross Domestic Product, for example, is estimated to have grown from 5.2% in 1978 to 33.6% in 1987 (Mtatikolo, 1994).

Referring to the Arusha Declaration and the private sector, the Executive Director of the Association of Tanzania Employers (ATE) stated in a paper interview that:

*The nationalizations of the 1960s and early 1970s put the private sector on the margin of business organization. Existing [business] organizations were reduced to clubs with little impact on economic and social policy (Business Times, August 26th, 1994:9 (cited in Nkya 1995).*

The Leadership Code of 1967 contributed also in stunting the indigenous entrepreneurship by defining a leader in terms of a salary level that was pegged so low that all college trained Tanzanians in formal employment were regarded as 'leaders' and therefore prohibited from owning property for rent, registered business, or holding directorship in private firms (Nyerere, 1968). The majority of the indigenous trained manpower that could have developed into entrepreneurs were, therefore, forced to depend on public service; and since it did not remunerate well they developed an attitude and behaviour of 'preying' (rent seeking) on public resources. The vacuum left in the private sector was filled by non-indigenous entrepreneurs who were not interested in working in low paying public service because they had other alternatives provided by their family businesses.

The suppression of the private sector and the surge of the public enterprise sector have received mixed interpretations in Tanzania. There is, for example, a recurring argument made in some Tanzanian public sector circles that the public enterprise sector has created a reservoir of managerial skills that could be tapped for the development of the private indigenous sector. This may, however, also be viewed as a constraint in the sense that the existing trained managerial cadre lacks business entrepreneurial experience because they have grown 'professionally' as government bureaucrats within a rent creating regulatory environment. Switching to new 'risk' taking roles may therefore be difficult and requires time to adjust. Unless incentives in the private sector are strong

enough to lure them into it, easy incomes from corruption in the public sector may have seemed more lucrative than staking out their meagre resources in an open competitive business (Nkya, 1995).

Since for a long period (1967-85) the public enterprise sector absorbed almost all the trained manpower, it may be plausible to assume that most of the available indigenous managerial manpower is deficient in competitive business ethics and prudence. They have grown in a public corporate environment which tolerated lax financial management supported by government subsidies (soft budget constraint) and they may therefore lack cost consciousness. The public enterprise sector was also used to reward political supporters through employment (patron-client relationships) such that not all former public sector managers are well skilled in business management and capable of transferring successfully to the private sector (Nkya, 1995).

### **Indigenous Capacity and Small and Medium Enterprises**

The majority of the indigenous entrepreneurs in Tanzania operate in the small and medium enterprise (SME) sector. The SME sector covers the non-farm activities and includes *micro* enterprises, *small* enterprises and *medium* size enterprises. Tanzania's national policy on the SME sector states that about a third of the Gross Domestic Product (GDP) originates from the sector. According to the Informal Sector Report of 1991, micro enterprises operating in the informal sector alone engaged about 3 million people (about 20% of Tanzanian labour force) in about 1.7 million businesses (URT, 2003). Schneider (2005) estimated that the size of informality in Tanzania as percentage of GDP increased from 58.3% in 1999 to 60.2% in 2003. Excluding traditional (peasant) agriculture, the informal sector employs about 55% of the total labour force in Tanzania (Tanzania, 2003). The debate on the capacity and development of the indigenous entrepreneurs should, therefore, focus on the SME sector.

In Tanzania *micro enterprises* are those engaging up to four people, mostly family members, in the informal sector, and deploying capital investment not exceeding Tshs 5 million. *Small enterprises* are mostly formal, engage between 5 and 49 people, and deploy capital investment from Tshs 5 to Tshs 200 million. *Medium enterprises* engage from 50 to 99 people and deploy capital investment of between Tshs 200 and Tshs 800 million (URT, 2003).

In a study of small scale enterprises, an area in which the indigenous entrepreneurs could have developed their potential, Bagachwa (1992b) discussed the Tanzanian government state-centred development policy actions that constrained the small-scale

sector. First, up to 1990 the sector was not included in the national development plans because the development strategy was geared to developing the large scale, centralized and monopolistic public enterprises. These large state-owned enterprises crowded-out small-scale private sector opportunities in areas where the indigenous private sector could have participated.

The National Milling Corporation is cited by Bagachwa (1992b) as to have monopolized the procurement and distribution of raw grains and milled products up to 1984. It undermined private investment in small scale custom mills by curtailing their access to the supply of raw grains. The small mills could not also serve district markets because they were not allowed to distribute milled grain products.

Another example cited from Coulson (1974) and UNDP/UNIDO/ILO (1988) studies is the establishment, in 1971, of a large scale automated bakery (SIHA) in Dar-es-Salaam which discouraged private small scale bakeries. Yet another example is the establishment of the Morogoro Leather and Shoe complex, the largest in Sub-Sahara Africa, which also eliminated small private dealers by undertaking vertically, integrated operations from raw material processing to the manufacture of final products (Bagachwa, 1992).

The macro-economic policies (up to 1986) were also used to undermine the small scale private sector which could have developed the entrepreneurial skills of the indigenous people. Credit rationing through the Finance and Credit Planning under the Bank of Tanzania, intended to channel credit to the high priority sectors, ended up allocating most of the loanable funds to the large-scale public sector firms. Between 1980 and 1987 (before policy changes were made), for example, the share of lending to the private sector by the commercial banks (all state-owned) was, on average, only 8.6% of the total lending as compared to the public sector share (government and state-owned enterprises) which averaged 91% over the same period (Nyagetera, 1992:77).

The enforcement of government regulations undermined also the development of the small private sector due to cumbersome, corruptive and long procedures of obtaining business licenses and certificates. While the regulations are necessary for a fair play in a business environment, the constraint to the small private sector is the manner in which the regulations were enforced. A major related problem in the Tanzanian policy environment was and still is lack of transparency, accountability and effectiveness in the enforcement of regulations. In Morogoro, for example, cases were then cited in which it took up to nine months to secure a license to operate a road side kiosk. Annual renewals of the licenses took up to three months. Withholding of necessary information as chips to exchange for petty bribes discouraged new entrepreneurs or raised substantially the cost of entry into business. Besides discouraging the small-scale

indigenous entrepreneurs, it also encouraged illegal or underground businesses and thus deprived government of the much needed revenue (Nkya, 1995).

Added to the above constraints was the weak organizational capacity of the private sector as a special interest group. Three main chambers of commerce that existed then were not well organized and were rigged with internal organizational tensions.<sup>1</sup> The TCCIA which was supposed to be an umbrella business organization for all the others is still defining itself and in rivalry with the other organizations.

### Current Policy Measures to Enhance Indigenous Entrepreneurial Capacity

The Small Industries Development Organization (SIDO), established far back in 1973, is the first major Tanzanian government effort to promote and develop the small scale enterprises in which most of the indigenous entrepreneurs are located or from where they have the potential to emerge. Before then, small enterprises were promoted under the auspices of the National Development Corporation (NDC), which in 1966 formed the National Small Industries Corporation as its subsidiary to promote small enterprises. More recent endeavours to enhance development of the private sector as a whole include establishment of the Tanzania Private Sector Foundation (TPSF) and Tanzania National Business Council (TNBC) to provide the main forum for public/private sector consultations on strategic issues of economic growth and development.

Various national policies include specific policy measures to enhance development of the small enterprise sector in which most of the indigenous entrepreneurs are located. The policies are: the Sustainable Industrial Development policy, National Micro Finance Policy, Minerals Policy of Tanzania, and the National Employment Policy.

Some specific policy measures are already underway by both the government and the private sector to strengthen the indigenous private sector. In 1994 the government established the National Entrepreneurship Development Fund (NEDF) to extend loans to the indigenous small-scale investors on more favourable terms than those of commercial banks. The loans are intended for starting or expanding business enterprises and also to enable the indigenous investors buy shares in the state-owned enterprises slated for privatization. The lending rates of NEDF in 1994 were 20% as compared with the 30% commercial rate then. The loans are repayable within 21 months and the borrower will be required to contribute 20% of the project cost (URT, 1994b). The current (2004) value of NEDF capital is Tshs 1.52 billion (SIDO, 2004).

<sup>1</sup> Tanzania Chamber of Commerce, Industry and Agriculture (TCCIA), Confederation of Tanzania Industries (CTI) and Dar es Salaam Merchants Chamber (DMC).

The government established Unit Trust Authority in 2003, which takes over the Privatization Trust Fund that had been holding a proportion of shares in privatized state-owned enterprises on behalf of the general public. The Unit Trust Authority will also pool investment funds from a large number of small investors and invest the funds in a diversified portfolio of investments, thereby spreading the risk that a single small investor could not have borne. A current development in this area is the establishment of Tanzania's first mutual trust (the Umoja Fund) in 2005.

Another government action was the adoption, in 1990, of the National Investment Policy (NIP) (Act No.10 of 1990, revised in 1998) which provides for specific measures to promote the small scale local investors. The Act provides for a category of investment areas that are exclusively reserved for local investors (Section 10c of the schedule) which include mainly the retail and wholesale trade, simple trades and operation of small common services (URT, 1990: 28).

A major action taken by the private sector to strengthen itself is the establishment of the Tanzania Venture Capital Fund (TVCF) Ltd to engage in equity and quasi-equity investments in a range of private sector companies which have clear potential for growth and profitability. The TVCF started with paid-up capital of US\$ 6.75 million, most of which is contributed by the Commonwealth Development Corporation (37%) and the German DEG (35%). Two Tanzanian financial institutions hold 12% of the shares.

The TVCF provides venture capital through equity co-financing of investments that have clear potential for success. Venture capital is a partnership between an entrepreneur and a supplier of risk capital (the venture fund). Venture capital is more favourable because it is not a loan and hence carries no financial obligation, no foreign exchange risk involved (dividends are paid in local currency), and requires no collateral (TVCF News, Vol.1, #1, November 1993).

In the final analysis, it is apparent that the policies which were pursued in the 1970s, and particularly those which provided for a 'soft budget constraint' in the public sector enterprises, affected adversely the entrepreneurial attitude and capacity among the indigenous managers who would have been the nucleus of an indigenous private sector. It is plausible to expect that these conditions will be an important concern for policy makers when considering the alternative forms of privatization (Nkya, 1995).

According to the Presidential Parastatal Sector Reform Commission (PSRC), out of the 281 units privatized up to June 2003, Tanzanians have managed to buy 140 units while

only 20 state-owned enterprises have been fully (100%) acquired by foreigners. The rest have been acquired jointly by foreigners and Tanzanians (URT, 2004).

## Conclusion

Debate on the controversy over the nature of indigenous people is far from settled and the outcome of the debate depends on who is defining an indigenous person. Politics and ideology seem to drive whatever definition adopted. However, it is found that entrepreneurial skills are lacking among those considered as indigenous in Tanzania, and among the empowerment measures adopted, development of entrepreneurial skill is high on the agenda. Analysis of the debate indicates that entrepreneurial capacity of the indigenous private sector and related aspects have increasingly shaped the rebalancing of the public-private sector relationship in favour of the private sector. Capacity of the private sector and policy measures to empower the indigenous private sector has been examined and found wanting. An illustrative case study on the indigenization debate is provided in the appendix of the handbook.

The following chapter examines the extent to which the political economy of the public-private sector rebalancing leads to strengthening of the domestic private sector, as the weight of the public sector is reduced in favour of the private sector. Central issues in the chapter revolve around the effect of globalization and non-governmental organizations on development policy making.

## Discussion Issue

*The low level indigenous entrepreneurial capacity in Tanzania reflects a legacy of the 1967 Arusha Declaration and contributes to a slow process of divesting the state-owned enterprises. To what extent do you subscribe to this assertion?*

## CHAPTER EIGHT

### Political Economy of Rebalancing Public-Private Sector Relationship, Globalization and Non-Governmental Organizations

#### The Setting

Underlying the public-private sector rebalancing process are issues related to Foreign Direct Investment (FDI) and the globalization phenomena. They invoke various issues related to political economy of the rebalancing process including winners and losers, public sector vested interests, international versus domestic capital, flows of incomes across borders and national control of economic policy agenda.

The purpose of this chapter is to examine the extent to which the political economy of the public-private sector rebalancing leads to strengthening of the domestic private sector as the weight of the public sector is reduced in favour of the private sector. In particular, the central issues revolve around the extent to which development policy making and implementation are affected adversely by the forces of globalization and international capital. In the context of 'high politics' the question is the extent to which national economic sovereignty is compromised by globalization in the process of changing the public-private sector relationship.

The main argument is that since the globalization phenomenon represents dramatic intensification of cross-border or international movement of goods, services and persons, the nature of the public-private sector rebalancing taking place is being driven and shaped by international forces beyond the control of the nation states. The nature and role of Non-Governmental Organizations (NGOs) in Less Developed Countries, where most of the NGOs are funded by foreign sources as an alternative channel for the transfer of resources, rationalises their discussion under globalization.

#### Political Economy and Modalities of Privatization

Besides the theoretical rationale which drives the preferences of the external donor agencies, privatization in Less Developed Countries is conducted within a political environment that is bound to favor particular modalities of privatization and restrict others. Bienen and Waterbury (1989) have presented three political economy constraints to divestment that can also be seen as influencing choice of forms of privatization

(broad definition). *First* is the origin of the public sector itself which draws in 'ideological rationale' for the public enterprises emphasizing the redistributive role of the state in pursuit of social justice. Any attempts to temper with this rationale have invited strong resistance from vested interests.

*Second* is the nature of coalitions with vested interests in the status quo. The 'dominant coalition' in SSA is comprised of the political elite, state-owned enterprises managers, organized labour, civil servants and professional middle class involved in the interventionist state. In reference to the import substitution strategy, Bienen and Waterbury (1989) argue that the dominant coalition operates with a 'social pact by which these groups trade political support or at least docility, for protection of their standard of living and a continued state commitment to redistribution' (p625). The social pact is comprised of a package of free social services, consumer subsidies and guaranteed employment. Privatization is therefore viewed as threatening these benefits.

A major paradox in connection to these coalitions is in regard to the major part of the private sector itself which has benefited from protection (tariffs), creation of domestic monopolistic conditions, and availability of subsidized inputs from the public enterprises. According to Bienen and Waterbury (1989), although the private sector would like some controls relaxed, it is not clear that they want to buy and operate the SOEs on a competitive basis. For them divestiture and related liberalization measures may remove some existing 'safety nets' provided by the state. It is likely that this private sector ambivalence may contribute to the pace and form of divestiture in SSA and it is an indication also that the 'economic base for popular capitalism is weak and so too is the pay off in terms of broad-based political support' (Bienen and Waterbury, 1989:627 cited in Nkya, 1995).

The *third* major constraint in the politics of divestment is the maintenance of power. According to Herbst (1982), 'the public sector expanded in Africa perhaps more from the need of political leaders for greater authority over their societies than from market failures or ideology' and that 'public enterprises provided political leaders with resources to distribute jobs, funds, and status; and allowed them to regulate a wide range of activities' (p628). The divestment form of privatization is seen therefore by some political leaders as diminishing their power base.

Other studies have added the *ethnic* and *indigenisation* dimensions to the politics of divestment. In countries with ethnic, religious or regional tensions, political stability has depended on a delicate social contract where public enterprises are used as instruments to create a balance of economic and political power (Adam, Cavendish and Mistry, 1992). Examples of such policies include the industrial 'growth pole' and regional

small scale 'industrial parks' which have been used in Tanzania and Kenya to locate industrial SOEs in regions which were neglected in the past. In such cases the divestment form of privatization is viewed as disturbing that balance. In Kenya, for example, the scope of divestment policies is limited by the fact that purchasers of SOEs are most likely to be Asian-Kenyans, Kikuyu tribe businessmen and foreigners, which is considered politically unacceptable (Van De Walle, 1989 cited in Nkya, 1995).

It has further been observed that divestment depends on the extent of the state's 'ideological investment' in public production. Van De Walle (1989) has mentioned countries like Tanzania and Algeria which promoted a large social, redistributive and economic role for the state in promotion of 'nationalism' such that reducing the role of state in the economy through divestment is viewed as politically risky and as an abandoning the nationalist project. In Tanzania, for example, the state-owned enterprises have been used to provide goods and services at prices which are below the cost of production, not only as a 'safety net' measure for the poor majority, but also as a way to enhance the legitimacy of the state (Hartmann, 1991 cited in Nkya, 1995).

### Globalization and Rebalancing the Public-Private Sector Relationship

#### *The Concept of Globalization*

The American Secretary of Labour illustrated a 'globalized' economy this way:

*The Pontiac Lemman is a car manufactured by General Motors. For every model that comes off the production line, roughly 30% goes to South Korea for assembly work, 17.5% to Japan for advanced technology components, 7.5% to Germany for design, 4% to Taiwan and Singapore for minor parts, 2.5% to the United Kingdom for advertizing and marketing services, and 1.5% to Ireland and Barbados for data processing. Only 37% of the initial value of this so called American car remains in the USA (Mbekou & Nziki, 1997, see the Courier Nr.164).*

Christopoulos (1997, in the Courier Nr.164) defines globalization as a context [process?] where the production factors - people, money, technology and equipment - as well as social and ecological problems, move increasingly across state borders. Globalization is viewed as a natural, one-way transformation from the industrial era of the 19th and early 20th century. This transformation was boosted in the 1980s by trade liberalization and the spectacular advance of information technologies, and in the 1990s by the ending of ideological models for organizing society, following the collapse of the Soviet Union.

Globalization is described as a complex interlinking process of production of goods and services organized on an international scale. It is based on technical innovation

and progress in the transport and communications sectors assisted by an international market which allows speedy movement of financial investments which greatly exceed the flows in the real economy. The picture is completed by the dismantling of trade barriers by a world body, the World Trade Organization (WTO), and by regional groupings. The result is international diversification of the production of goods and services. The pursuit of short-term profit on globalized currency and bond markets makes turbulence more likely, threatening national payment systems and the stability of the real economy. Globalization has been given a boost by several factors such as technical progress, the end of the Cold War, abandonment of central planning, liberalization of capital movements and exchange controls (Mbekou and Nziki, 1997, see the Courier Nr.164).

Globalization as a concept is not a new phenomenon. Economic internationalization through trade -mercantilism- has been the foundation of capitalist society since the 16th century. For example, the ratio of international trade to production for MDCs has always been considerable (it was already 12.9% in 1913 and today it is around 14%). However, factors that make globalization a current topical issue are (David, 1997):

- i. Transition from growth centred on domestic demand to an export demand-centred growth.
- ii. Expansion of the multilateral nature of Direct Foreign Investment (DFI).
- iii. International trade is growing much faster than production.
- iv. Internationalization of financial markets.
- v. Falling cost and increasing speed of transmitting information.

#### *Legitimacy and Rationale for Globalization*

Justification of the globalization phenomenon is based mainly on the following economic and technological arguments:

- i. Making the international division of labour, economies of scale, and competition more efficient.
- ii. Wider availability of various technologies.
- iii. The orthodox view that Less Developed Countries are able to catch-up with modern technology more rapidly. International Monetary Fund argues, for example, that globalization is enabling Less Developed Countries acquire new knowledge and technologies, irrespective of their level of development. They argue further that there is no limit on government autonomy, only a restriction on making economic policy errors.

What is not, discussed however, is how those countries could acquire new knowledge and technologies given their low level of capacity in terms of financing and technical capability.

### Effects of Globalization

The long-run impact of the surging globalization on the poor third world countries may not be properly gauged now. The following immediate effects are, however, very vivid at present:

- i. A tendency to equalize world prices without equalizing incomes. In this process, countries like Tanzania are 'integrated' as consumers and 'marginalized' as producers - a situation which has a limit beyond which such countries cannot consume.
- ii. Relative erosion of conventional and traditional powers, particularly state or inter-state powers.
- iii. Increasing power of networks as counterbalances, particularly global undertakings and financial markets.
- iv. Annual flows of Foreign Direct Investment (FDI) throughout the world rose from \$60 bln to \$315 bln over 10 years, rising by at least 40% in 1995 alone. FDI accounts for more than 54% of all private capital invested in Less Developed Countries, which suggests that foreign capital must be controlling national ones. In Tanzania FDI increased from US\$ 157.8 millions in 1997 to US\$ 300 millions in 2003, an increase of about 90 percent.
- v. Globalization makes national economies more vulnerable to policy mistakes.
- vi. Precipitation of income inequality between and within nations. The bulk of globalization benefits accrue to a small and privileged minority. Some countries and regions are losing out. Sub-Saharan Africa, for example, in some respects is experiencing the harmful effects of globalization. Many African countries are becoming marginalized globally with increasing social divisions at national level. Africa's share of overall capital flows to the developing world fell from 33% in the 1970s to only 6% in the period 1986-95. Asia receives 65% of total FDI compared with 27% for Latin America. Africa attracts only \$5 billion (about 3% of the total), and mainly to four oil producing countries.
- vii. SSA with 520 mln inhabitants and 52 states generates only 2% of world GDP (\$250 bln, 90 of which is accounted for by South Africa alone), 1.7% of world exports and less than 1% of world industrial added value. The terms of trade declined by 30% between 1982 and 1990. Yet between 1980 and 1989 a total of 241 stabilization and structural adjustment programmes were implemented with the help of the IMF and the World Bank.
- viii. Rise of the 'virtual economy' (speculative economy) with no links to production (real economy). A very large percentage of financial transactions have no counterpart in exchange of goods and services, nor in investment. According to the Bank of International Settlements (1994-95), of the \$1400 bln worth of transactions daily on the world's exchanges, only between 5% and 8% can be considered 'real economy'.

- ix. More and more problems and their solutions are interdependent such that isolated measures by individual nations, ignoring the fact that what others do might influence their decisions, are not only inefficient but can also have disastrous consequences. This calls for a need for 'strategic choices' by nations.
- x. Natural resources are no longer the decisive production factor. The process of trade liberalization and freer movement of people, goods and services means that natural resources are becoming increasingly available, irrespective of national borders. *Human resources are increasing in value.* The modern worker must demonstrate skills that are information intensive, as well as continuous learning capacity. Value depends on ideas and patents rather than routine production of goods and services.
- xi. There is unsubstantiated fear that more investment in, and higher imports from low-cost Less Developed Countries to More Developed Countries harm employment in the latter, especially in labour-intensive production, leading to greater disparities in salary levels and job displacements. There is a drop in the demand for unqualified labour and decrease in earnings for those with few qualifications. But the small proportion of trade between Less Developed Countries and More Developed Countries (about 3.52% of More Developed Countries Gross National Product in 1994, up from 2.6% in 1972) may not support such an argument. Also More Developed Countries invest only 0.5% of their GNP in Less Developed Countries.
- xii. Globalization processes are homogenizing all cultures into a universal market-oriented culture.
- xiii. Linguists predict that worldwide, 6000 languages will die out in the next 75 to 100 years and that only 300 languages have a relatively secure future (Christopoulos, 1997 in the *Courier* Nr.164).

In regard to the above effects, it is important to recognize that there are wide variations in the ways in which they affect the various poor countries. The impact of the effects depends on the national context in terms of the level of economic development, technological capability, resource endowment, economic governance, levels of education and institutions. The same effects are likely to marginalize some countries while benefiting others.

### Actions Needed by Nations to Cope with Globalization

Important, however, is the nature of national response to the globalization phenomenon. Since globalization is now considered as given and unavoidable, a practical way of considering national response is to search for ways of coping strategically. Itemized below are the various ways suggested for coping with globalization:

- i. Redefined foreign relations based on 'strategic choices' and 'strategic alliances' with other states and regional/international organizations, to promote their human resources, profit from the wider knowledge and experience available worldwide.
- ii. Education to maximize the use value of *human resources*. In the past, wealth may have been measured mainly in terms of physical resources, but globalization has changed all that and human resources are increasing in value. Globalization leads to money circulating more easily around the world. What induce it to stop somewhere are the skills of a country's workforce and the quality of its infrastructure. Well trained workers will always attract investment. In globalization, therefore, *human resource development through education is the main challenge and area requiring strategic planning*.
- iii. Networking of information, services and human resources at national and international levels is essential in globalization. This leads to augmenting domestic social capital. According to Robert Putnam *social capital* entails features of social organization such as reciprocity networks, norms and trust that facilitate coordination and cooperation for mutual benefit. At macro level social capital includes cohesion, political stability, security, and civil peace. Social capital enhances the benefits of investment in physical and human capital (World Bank Development Economics Report, 1996).
- iv. Flexibility in decision-making processes.
- v. Governments must be vigilant actors in the regulation of globalization to soften the destabilising effects. Others have called for "globalization with a human face" (Christopoulos, 1997 in the *Courier* Nr.164).

### Non-Governmental Organizations and Public-Private Sector Relationship

Non-Governmental Organizations (NGOs) have emerged as vital partners in the *new pragmatism* of the development process and privatization in particular. There is no unified definition of NGOs apart from the self-defining term: *non-governmental organization* - not created or related to government. Some definitions have been put forward by various country policy statements, however.

The World Bank defines an NGO as:

*an association, society, foundation, charitable trust, non-profit corporation, or other juridical person that is not regarded under particular legal system a part of the governmental sector and that is not operated for profit - viz. if any profits are earned, they are not and cannot be distributed as such. It does not include trade unions, political*

*parties, profit-distributing cooperatives, or churches* (World Bank, cited in URT, 1997).

A more development-oriented definition is given by the Government of Kenya as:

*A private voluntary grouping of individuals or associations not operated for profit or for other commercial purposes but which have organized themselves nationally or internationally for the benefit of the public at large and for the promotion of social welfare, development, charity or research in the areas inclusive of, but not restricted to, health, relief, agriculture, education, industry and the supply of amenities and services* (Government of Kenya, cited in URT, 1997).

In the Tanzania's Draft National Policy an NGO is defined as a private voluntary grouping of individuals or associations which is not for profit making, organized locally, nationally or internationally, for enhancing the economic and social equity of target groups as mutually agreed by all stakeholders (URT, 1997).

The following main definitional characteristics of NGOs can therefore be identified:

- i. *Voluntarism*: i.e. an NGO is voluntary, that is formed voluntarily without a law enforcing the community to form such an organization.
- ii. *Independence*: i.e. controlled by community for their own benefits.
- iii. *Not-for-profit*: i.e. it can generate profit (surplus) but use it according to their stipulated objectives and not share dividends.
- iv. *Not self-serving*: i.e. works for the community (URT, 1997).

### Legal Framework for Non-Governmental Organizations in Tanzania

There is no single legislation under which Non-Governmental Organizations (NGOs) are established in Tanzania. It is, therefore, difficult to have a unified overall goal for the NGOs and also to monitor them. Currently NGOs are established in Tanzania under the following five legislations:

- i. Societies Ordinance Cap. 337 of 1954
- ii. Companies Ordinance Cap. 212 of 1956
- iii. The National Sports Act No. 12 of 1967
- iv. Trustees Incorporation Cap. 375 of 1956
- v. Societies Act No. 6 of 1995 (for Zanzibar).

NGOs are increasingly becoming important development partners in poor countries, such that it is imperative to understand their impact on development. Monitoring of NGOs is, therefore, a critical activity to ensure proper guidance towards national

development policies and programmes. Attempts are underway to have a unified national policy and legal framework for NGOs in Tanzania.

### *Justification for Non-Governmental Organizations*

It is argued by Clark (1991) that Non-Governmental Organizations (NGOs) are a tool to *democratize* development and are capable of reaching out to poverty-stricken groups. As characterized by Chambers (1983), *poverty* is an *interlocking web* of five factors each of which feeds off and exacerbates the others: *poverty* itself (lack of "capability for entitlement"), *physical weakness* (health), *isolation* (lack of contact in physical and social terms), *vulnerability* (to natural disasters, exploitation, social conventions such as dowry), and *powerlessness* (to prevent exploitation, violence, blackmail, and to negotiate). John Clark (op. cit) adds environmental damage and gender discrimination.

NGOs justification emanates from their *strengths*, which are political independence, low cost and thus easy to finance, serving the poor, smallness, accessibility, grassroots' participation, innovation, commitment of staff, and reduced bureaucracy. Their *weaknesses* emanate also from their strengths. As Sheldon Annis (1987) put it;

*In the face of pervasive poverty "small scale" can merely mean "insignificant," "politically independent" can mean "powerlessness" or "disconnected," low cost" can mean "underfinanced" or "poor quality," and "innovative" can mean simply "temporary" or "unsustainable." (cited in Clark, 1991:54).*

Other weaknesses revolve around leadership, legitimacy, management capacity, including planning, accountability, relationship with governments, and scaling-up. In Tanzania, for example, some NGOs have their offices in the founders' briefcases. More often the primary motivation of establishing NGOs is the possibility of sourcing donor funds.

### *Categories of Non-Governmental Organizations*

Review of literature indicates the following categories of Non-Governmental Organizations (NGOs) in developing countries:

#### *Relief and welfare agencies*

These are NGOs that provide relief such as orphanage services.

### *Technical innovation organizations*

NGOs that operate their own projects to pioneer new approaches to problems, and which tend to remain specialized in their chosen field. An example is the Grameen Bank of Bangladesh.

### *Public service contractors*

NGOs that are contracted to implement components of official programmes because of their flexibility and size which help them perform the tasks more effectively than government departments. An example of this is CARE.

### *Popular development agencies*

NGOs that concentrate on self-help, social development and grassroots democracy.

### *Grassroot development organizations*

NGOs whose members are poor and oppressed and which try to shape a popular development process. An example is Self Employed Women Association.

### *Advocacy groups and networks*

Organizations that have no field projects but exist primarily for education and lobbying (Clark, 1991).

In practice, however, some NGOs are a mixture or blend of the above types.

### *Impact of NGOs*

NGOs are increasingly becoming important development partners in developing countries and inquiry is also increasingly focusing on their impact on development. Issues have been raised questioning the extent to which NGOs, which are considered a 'drop in the ocean' of poverty, could make a difference in alleviating poverty. It has been argued that they are too small to make any meaningful impact. But it is also argued in this handbook that a critical mass of NGOs is needed in order to make a meaningful impact. Public policies should therefore lower the barriers to their entry.

In 1989, for example, NGOs shifted US\$6.4 billion to the developing countries, which was about 12% of all Western aid, public and private. In terms of *net transfers*, NGO collectively contribute more than the World Bank. The Bank invests more each year in developing countries, but when the debt service for past loans is deducted from the gross figure the resulting net transfer is smaller than that of NGOs (Clark, 1991).

## Conclusion

Rebalancing public-private sector relationship entails political economy constraints and issues related to winners and losers, public sector vested interests, international versus domestic capital, flows of incomes across borders and national control of economic policy agenda. These constraints weigh heavily on development policy making in Tanzania and many other developing countries.

In regard to globalization, major issues revolve around the extent to which development policy making and implementation are affected by the forces of globalization and international capital. Particular concern is the extent to which national economic sovereignty may be compromised by globalization in the process of changing the public-private sector relationship. Given their weak knowledge and technological capacity, Tanzania and other developing countries are concerned about real marginalization arising from globalization. Strategic alliances are important to avoid marginalization.

Non-Governmental Organizations (NGOs) are increasingly becoming important development partners in developing countries. However, their impact is also increasingly being questioned as it is considered a 'drop in the ocean' of poverty. It has been argued that they are too small to make any meaningful impact. But it is also argued in this handbook that a critical mass of NGOs is needed in order to make a meaningful impact. Public policies should therefore lower the barriers to their entry.

The following chapter discusses economic regulation as the major remaining role of public sector authorities after rebalancing the public-private sector relationship in favour of the private sector. Regulations and standards are important for providing information necessary for economic actors to make informed decisions on a level playing field.

## Discussion Issues

- i. *To what extent do you agree with Sheldon Annis's (1987) contention that Non-Governmental Organizations' (NGOs) strengths are also their weaknesses?*
- ii. *What is the relevance of NGOs to the privatization policy in Tanzania? What modalities of privatization could be linked with NGOs?*
- iii. *Citing a case in your experience or library research, discuss how political dimensions have affected privatization of the state-owned enterprises in Tanzania.*
- iv. *Citing examples of public utilities in Tanzania, use the concepts of economic, political, and social capital to justify the slow process of their (utilities) divestiture.*
- v. *To what extent do you consider the 'globalization' issue the driving force behind privatization in Tanzania?*
- vi. *What effects of globalization are more relevant to Tanzania?*
- vii. *How could a country like Tanzania cope with globalization?*

## ECONOMIC REGULATION

## The Setting

Public-private sector relationship in the economic sphere should have a mechanism to regulate it for the interest of all economic actors. Regulations and standards are important for providing information necessary for economic actors to make informed decisions on a 'level playing field' and protect consumers. The transition from state-centred to market-centred economic development requires a balanced economic regulation leading to fast economic growth through enhanced productivity. Dynamic regulation is necessary to mitigate market failures in a competitive economy and to facilitate efficiency. A major role of state in market-led economic development is to employ its legitimate public authority to set and implement rules, regulations and standards in order to provide a level playing field for economic agents, protect consumers and support fair competition.

The purpose of this chapter is to review the concept and theory of economic regulation, examine the main objectives of regulation, forms of regulation, regulatory instruments, and the intractable process of striking the right balance in economic regulation. The main argument is that economic regulation can be a double-edged sword if a right balance is not struck. A wrong balance could retard growth.

## The Concept and Theory of Economic Regulation

Literally regulation means control of activities by an independent agency through a set rules, regulations and standards to ensure regulatory effectiveness. Regulation is a 'watch dog' or a standing control of forces that attempt to compromise a legitimate system. In defining regulation, Hood et al. (1999) underscores public authority as the source of regulation and defines it as "the use of public authority to set and apply rules and standards" (cited in Cook 2003). However, Yilmaz (1998) argues that economic regulation is not done by government only. It is argued that much regulation is private, produced and enforced by independent parties or trade associations, which can oversee market actors through different processes such as setting standards, certification, monitoring, brand approval, warranties, product evaluations, and arbitration.

The 1980s shift from state-centred to market-centred development has given rise to a changed role of state from direct production of goods and services to ensuring provisioning of the goods through the non-state sector. The shift has given rise to what Majone (in Cook et al., 2003) calls "regulatory state" or what Jackson and Price (1994) refer to as the 'invisible hand' of the market being supplemented by the "visible hand" of regulators. In the new approach "the state ceases to be directly concerned with the provision of goods and services and instead concentrates upon regulating private markets to promote economic and social welfare" (Cook et al. 2003).

Underlying the theory of economic regulation is the concept of "market failure". Cook et al. (2003) argue that market failure exists when the market is unable to produce an outcome that maximises economic welfare through competitive prices because of lack of competitive markets. Without competitive markets and competitive prices, a Pareto optimal outcome is not possible. A Pareto optimal outcome is one in which there is no possibility of making anyone else better off without making someone else worse off such that no further resource reallocation would improve economic welfare. Since, in practice, the restrictive assumptions for a Pareto optimum are not realizable, particularly in poor countries, unregulated markets cannot be expected to maximise economic welfare. Reasons articulated by Cook for market failure in developing countries include:

- i. Poor information or asymmetries in the market such that consumers and producers are unable to make decisions optimally so as to maximise their welfare.
- ii. Natural monopoly that inhibits competition. A natural monopoly occurs where there are appreciable economies of scale or scope. In developing countries natural monopoly may be pervasive because the market is insufficiently large to sustain a number of competing operators operating at an efficient scale.
- iii. Pervasive externalities in the form of costs (or benefits) to agents who are not involved in the immediate transaction.
- iv. Failure of private markets to produce the level and pattern of economic growth necessary to reduce poverty levels. State economic regulation is intended to promote economic development and to ensure that markets and private sector contribute to poverty reduction (Cook, et al 2003).

It is important, however, to recognize that "unbalanced" and poorly managed economic regulation can result in a corollary of market failure; the problem of "state failure" where regulatory machinery is "captured" by self or group interest at the detriment of public interest. One form of capture is "political capture" which is a form of regulatory capture where regulation is "designed and promoted to meet needs of the political elite to preserve its power" (Cook, et al 2003).

In order to avoid the pitfalls of regulatory capture, Haskins (2000) provides the following five attributes of effective regulation:

- i. Transparency, which refers to the regulatory process being open to public scrutiny and allows the public to appreciate the grounds for regulatory decisions and facilitates public consultation and challenge.
- ii. Accountability, in which regulation is answerable to the public.
- iii. Targeting, in which regulatory system is one in which the regulations introduced to correct market failure are not so loosely drafted that they impact unintentionally on other parts of the economy.
- iv. Proportionality, which is concerned with regulation introduced being proportional to the problem or market failure identified.
- v. Consistency, in which regulatory decisions become more predictable, leading to less disruption to the economy and the private sector.
- vi. Regulatory costs (costs of regulatory structures and compliance costs) should be minimized (Parker, 2002, cited in Cook et al; 2003). Administrative and compliance costs of regulation should be compared to the benefits accruing from the regulation, to promoting efficiency in the administration of regulation. Yilmaz (1998) considers also “hidden or indirect costs” or opportunity costs of regulation, which include benefits that could have been attained if available government and private resources had not been devoted to excessive regulatory activity.
- vii. Regulatory risk, which arises from uncertainty and inconsistency in the regulatory regime, is another attribute that leaves private sector fearful of current and future regulatory decisions.

### Goals and Economic Rationale of Economic Regulation

Why regulate? Public-private sector relationship and market economy cannot function properly in the interests of economic actors without rules and regulations. The goal of regulation is to enhance productivity through provision of level playing field for all economic actors and protect consumers. Rules and regulations cover a wide range of economic sphere, including property rights to protect innovators, mitigation of market failure effects, protection of consumers and workers, and support of fair competition (Beardsley and Farrell, 2005).

According to the World Bank (2004), goals of economic regulation include four basic elements:

- Protection of consumers from private sector abuses and political interference;
- Protection of the private sector from politically-driven decisions;
- Enabling the public sector to carry out long-term policy objectives;

- Ensuring quality or shared growth, which is sustainable and alleviates poverty.

While any relationship has to be regulated by rules, regulations, laws, norms or contracts, overall economic regulation of the public-private sector relationship has, however, to be regulated mainly by one of the parties in the relationship; the public authority. Discussions in previous chapters have shown that there are various problems inherent in this characteristic, including principal-agent problems and related information asymmetries. Systemic measures deployed to deal with such imbalance of power in the public-private sector relationship include consultations with the private sector during policy making process, enactment of independent judiciary and independent regulation.

### Regulatory Functions

Economic regulation is carried out not only by government; but also by other bodies such as associations, private organizations and by self-regulation. These various organizations do not, however, carry out all regulatory functions all the time. Regulatory functions carried out by an agency depend on the nature of the agency and its area of jurisdiction, geographically and functionally. The major regulatory functions are described briefly below.

#### *Regulation of Competition*

The likely market failures in a market economy necessitate competition regulation, which ensures that operators compete on a level playing field characterised by fair and transparent market. For example, natural monopolies such as utilities, which tend to benefit from low average costs due to large size and exclusivity conditions over a defined market area, have to be regulated to protect customers and smaller producers from monopoly prices. Regulators may also have to perform “comparative competition”, in order to replicate competitive pressures for the setting of prices and quality standards. Regulators may also need to ensure that new small-scale entrants have access to the market to prevent misuse of monopoly power (World Bank, 2004). Box 9.1 below illustrates economic regulation in Tanzania, which regulates competition and protects consumers.

### Box 9.1

#### TANZANIA: THE FAIR COMPETITION COMMISSION

The Fair Competition Commission (FCC) is an independent government body established under the Fair Competition Act nr 8 of 2003 to promote and protect effective competition in trade and commerce and to protect consumers from unfair and misleading market conduct. The ultimate goal of the Act is to increase efficiency in the production, distribution and supply of goods and services. The objective of this Act is to enhance the welfare of the people of Tanzania as a whole by promoting and protecting effective competition in markets and preventing unfair and misleading market conduct throughout Tanzania in order to:

- Increase efficiency in the production, distribution and supply of goods and services;
- Promote innovation;
- Maximize the efficient allocation of resources; and
- Protect consumers.

#### *Consumer Protection*

Market failures necessitate also consumer or customer protection from abusive practices of producers and providers or sellers of goods and services through setting standards of quality and, in some cases, setting price ceilings. The function is particularly important where providers are natural monopolies. In the case of services, customer protection entails defining levels of service that sustainably meet customer needs at affordable cost, and ensures dynamic sustainability of such levels through monitoring. Consumer protection includes also providing complaint resolution mechanisms that may not require resort to judicial systems and information to raise consumer awareness.

#### *Price Regulation*

In the context of market failures, and particularly in utilities, price regulation entails setting price structures and levels in order to ensure delivery of goods and services to customers at affordable cost while also ensuring the long term cost effectiveness, financial viability and efficiency of the producing sectors. Price regulation has also to be dynamic so as to capture periodic changes in the economies of the producing sectors. Regulatory dynamism entails periodic price reviews by the regulatory bodies so as to capture changes in the production structures and in consumption patterns. Owing to market failures, the changes are not usually captured by market

forces and, if not controlled or regulated, could disrupt or distort markets of various goods and services to the detriment of consumers. Box 9.2 below illustrates the functions of the Tanzanian regulatory body for energy and water in regulating utility prices and consumer protection.

### Box 9.2

#### TANZANIA: ENERGY AND WATER UTILITIES REGULATORY AUTHORITY (EWURA)

The Government of Tanzania, through an Act of Parliament, has established the Energy and Water Utilities Regulatory Authority (EWURA). EWURA is responsible for licensing, tariff regulation and quality of service regulation of the electricity, water, petroleum and natural gas sectors. EWURA carries out the following generic tasks related to safety and economic regulation:

- Establishing safety standards for the utility sectors;
- Monitoring and enforcing safety performance;
- Licensing and enforcing license conditions;
- Providing advice on industry cost structures;
- Providing advice on service quality objectives to ensure they are captured in tariff reviews;
- Providing advice on fair network access and competition issues.

#### Forms of Regulation

Who should perform economic regulation and in what form? Underlying forms of economic regulation are mainly ideological issues related to the most appropriate relationship between market and state. Approaches to regulation are also influenced by a combination of economic, social, political and bureaucratic factors, which determine the nature of regulatory governance (Cook et al., 2003). The political economy of economic regulation in terms of who gains and loses, determines, therefore, what forms of regulation would be adopted by policy makers. Context is also critical in deciding on what forms of regulation to adopt. Adoption of the following forms of economic regulation would depend much on the socio-economic context in which they are likely to operate (Yilmaz, 1998; Cook et al, 2003).

### Government Economic Regulation

In market-led economies and those in transition to free market development, the role of the state in "guiding" the market is critical. As states in countries that had a long practice of state-led development are displaced from direct production of goods and services, the state has been searching for a "new" role in the economy. Based on the plausible argument of market failure, particularly in poor countries, enhanced regulatory role of government at both local and central levels is increasingly becoming necessary. Other plausible arguments for the state to be involved in economic regulation in poor countries include the need to guide the private sector towards poverty alleviation, inherent power and capacity of the state to enforce laws and regulations arising from democratic legitimacy of the state, and equitable distribution of opportunities and incomes across the entire country. In the case of Tanzania, for example, apart from the increased number of regulatory legislations, several sectoral regulatory agencies have been established.

The following regulatory bodies were established in the past five years:

- Tanzania Civil Aviation Authority (TCAA);
- Tanzania Communication Regulatory Authority (TCRA);
- Surface and Marine Transportation Authority (SUMATRA);
- Energy and Water Utilities Authority (EWURA);
- Fair Competition Commission (FCC).

The regulatory functions of the FCC and EWURA are illustrated in boxes 9.1 and 9.2 above. The government regulates also through professional bodies established by government to set and enforce standards, such as the National Board of Accountants and Auditors (NBAA) and the National Board of Materials Management (NBMM).

Box 9.3 below illustrates how EWURA in Tanzania regulates the two areas under its jurisdiction: water and sewerage, and electricity.

### Box 9.3

#### TANZANIA: ENERGY AND WATER UTILITIES REGULATORY AUTHORITY (EWURA)

In the areas of Water and Sewerage EWURA will perform the following specific tasks:

- Manage safety and environmental regulatory functions set out in the EWURA Act and relevant sectoral Acts;
- Coordinate contractual role of Dar es Salaam Water and Sewerage Authority and the oversight of the water concessionaire;
- Coordinate the regulatory role of water authorities;
- Monitor and enforce all technical, environmental and safety aspects of concession contracts, including liaison with the Tanzania Bureau of Standard.

In the area of Electricity EWURA will perform the following specific tasks:

- Oversee licensing, monitoring, safety and environmental control and enforcement functions set out in the EWURA Act and relevant sectoral Acts;
- Monitor and enforce all technical, environmental and safety aspects of electric utility licensees;
- Advise the Board on technical, environmental and safety aspects of new license issues, and draft contracts with the new power generators.

### Independent and Private Third Party Economic Regulation

A major part of economic regulation is carried out by non-state sectors, including the private sector, trade associations and quality groups to maintain quality standards. Most of the non-state regulators deal with setting standards for quality control, certification and arbitration. It has been argued by Yilmaz (1998) that independent third parties in regulatory process may reduce compliance costs by businesses and individuals because it collapses the costly command-and-control nature of government regulation. In Tanzania, for example, some of the business associations such as the Confederation of Tanzanian Industry (CTI) and the Private Sector Foundation (PSF) perform some regulatory functions in their areas of interest, including setting business ethics, which assist government regulatory function.

### Business Regulation

This broad brush of business regulation involves regulatory controls exerted over the non-state sector including private business, public sector business and small scale businesses. The Tanzanian Fair Competition Commission (FCC) discussed above regulates most of the activities in this regulatory category. Business regulation include tax regulations, anti-trust regulations, brand names, business registration, estate property rights, intellectual property rights, labour protection laws, and child labour laws.

#### *Regulation of Utilities*

Given the “public good” and “monopoly” nature of most utilities, their regulation is carried out mainly by the state or designated state agencies established by enacted laws of the land.

Utility regulation is meant to enhance efficiency through providing for competition, and price and service quality regulation. Other objectives of utility regulation are consumer protection through defining levels of service, and setting safety standards (see boxes 9.2 and 9.3 above; and World Bank, 2003).

#### *International Economic Regulation*

In an increasingly globalizing world, some economic activities in a country may be regulated by international regulation and regulatory bodies such as the World Trade Organization (WTO), regional integration bodies and international financial institutions. The international regulations may also find their way in national regulations if a country is a signatory of international conventions. Most of the international economic regulations are focused on enhancing competition on the international market without, however, enabling the poor member countries to compete effectively. Such regulations cut across all member countries and they amount to giving up part of national regulatory sovereignty that is expected to be paid-off by compensating benefits of being a member. Some of the international regulations require national economies to harmonize their national regulations with the international regulations if they are contradictory.

#### *Self Economic Regulation*

Self economic regulation entails voluntary positive response to mutually agreed regulations on economic activities and outputs or uncontrolled adherence to regulations set by government regulators and without regulatory agencies. Mutual trust, norms and ethics of an association may require that members adhere to government or their own regulations. Self-monitoring and reporting are part of self regulation.

### **Regulatory Instruments**

Cost of production, cost of regulation, benefit of a regulation and feasibility of compliance are bound to be the key criteria for choosing a regulatory instrument. A regulator must get the right information about the cost structure of a producer of a good or service and also understand the benefits accruing to the economy and individual providers as cost of compliance. Failure to get the right information may distort the market and discourage investment in the production of goods and services. More often governments have been characterized as “over-regulators” when they missed the right balance between regulation and deregulation.

The “right regulatory balance” is a function of several factors including regulatory capacity, initial market conditions, national institutional framework, political economy of regulation, politics and choice of regulatory instruments. This section is concerned with regulatory instruments, which are described by Cook et al. (2003) as “the tools and techniques that the regulator uses in the pursuit of effective regulation”. The main instruments presented by Paul Cook and others are delineated below.

#### *Cost of Service or Rate of Return Regulation*

In this instrument, which is a sort of cost-plus pricing, the regulator agrees with the regulated firm on the level of operating costs and spread of capital costs for the regulatory period. Then profit or agreed rate of return based on the firm’s cost of capital is added to cost giving the level of revenue needed to achieve the agreed rate of return. Once the volume of output is forecast then the necessary prices that need to be set are determined. If profits turn out to be higher than agreed, the firm is expected to cut its prices to restore the agreed level of profit. The weakness of this approach is that cost of service regulation is associated with disincentives to reduce operating and capital costs because these can be passed through to consumers in higher prices, and incentives to over-invest, thereby expanding the asset base on which the allowed rate of return is calculated (Averch and Johnson, 1962, cited in Cook et al., 2003).

#### *Price Cap Regulation*

In this approach profits are not determined by the regulator; they are a residual. The regulator agrees with the regulated firm on the forecast operating and capital costs and then applies an “efficiency gain factor”, which is normally based on some estimate of productivity growth in the industry compared to the economy in general. The estimation of the efficiency factor may result from “benchmarking the firm’s performance with other firms’ efficiency growth across the industry or with

similar industries within the country or internationally". (Cook et al, 2003). Average productivity growth across the economy is reflected in price inflation or the Consumer Price Index (CPI). Higher or lower than expected productivity growth in the regulated sector is reflected in the efficiency gain factor price adjustment. The formula for the price cap is therefore, *CPI plus or minus efficiency gain factor*. "The result is an incentive for the firm to out-perform in terms of reducing costs or attracting customers, leading to higher profits" (Littlechild, 1983; Viehoff, 1995 cited in Cook et al, 2003).

#### *Sliding Scale Regulation*

The sliding scale technique involves a combination of price cap and cost of service techniques. The price cap operates up to a given level of reported profit and when profit exceeds that level, consumer price is proportionately reduced (Burns et al. 1995, cited in Cook et al, 2003). "This approach to regulation ensures that profits cannot be excessive for long periods and helps reduce political and social opposition to the regulatory regime that can exist when profits rise sharply, especially in what are perceived to be essential public services such as water and power" (Parker, 1998 cited in Cook et al 2003).

#### **Regulatory Challenges in Developing Countries**

The main challenge facing less developed countries in regulatory regimes is how to design economic regulations that do not hinder competition and economic growth. 'Getting regulation right' is the major challenge in many developing economies (Beardsley and Farrell, 2005). Getting regulation right requires not only regulatory capacity in terms of expertise, but also regulatory policy flexibility. Trial and error approach is important in economic regulation in capacity constrained economies. Governments in poor economies struggle to create flexible regulatory regimes that can anticipate and respond effectively to market development conditions. More often poor countries design inappropriate and unevenly enforced economic regulations. In some countries, economic regulations have scared away foreign investors and discouraged domestic investment endeavours. unintended effects of regulatory regimes have often retarded economic growth in poor countries. Beardsley and Farrell (2005) have discussed the following 'common regulatory traps' that may be interpreted as major real challenges in economic regulation.

#### *Inappropriate Regulation of Factors of Production*

Inappropriate economic regulation entails fixing factor price ceilings or restriction of movement of factors in response to market signals. Labour market regulations, which fix minimum wage, restrictive land and property regulations, and restrictions

on capital markets, often lead to market distortions that may adversely affect economic growth and development.

#### *Overregulation of Competitive Sectors*

Protectionist market entry regulations insulate local companies from competition, which lead to high consumer prices and low quality of goods and services. Innovation is also stifled by unnecessary restrictive product market regulations because lack of competition allows firms to slumber.

#### *Inflexible Regulation of Utilities*

Utilities are usually managed by huge enterprises with heavy investment costs that cannot be made by smaller enterprises, a situation that creates natural monopolies. In an attempt to reduce the market power of utility companies, governments have tried to create competition in utility markets by unbundling the monopolies and creating smaller retailer and distribution enterprises for specific related activities. By so doing, consumer prices have in some cases gone down and in others, up. The problem again is how to strike a regulatory balance that would both sustain production of services and protect the consumer from poor quality and high prices. It is therefore important that flexible regulatory frameworks are innovatively designed to respond to evolving market conditions.

#### *Enforcement of Regulations*

Enforcement of regulations is considered the major missing link in economic regulation in most poor countries. Even when regulations are well balanced, poor enforcement as part of implementation is bound to make regulation a mere academic exercise without any effective impact. Regulatory bodies have to carry sufficient legitimacy and influence in order to enforce rules. There has also to be an effective link between regulators, law enforcers and the judiciary. In several cases enforcement issues can be addressed through the setting up of specific bodies that can deal with appeals from regulatory decisions on rule enforcement (World Bank, 2004).

#### **Getting Economic Regulation Right: A Key Regulatory Challenge**

A major regulatory challenge is how to get regulation right. There is no one fixed formulae for getting it right; it all depends on the socio-economic and political context. Beardsley and Farrell (2005) have suggested the following guidelines for making regulations more context-effective.

### *Information-based and Transparent Regulation*

Information on real facts and transparency are important in analyzing trade-offs in various approaches to regulation. It is also important to analyse political and social implications of the various approaches. Benchmarking against relevant international regulatory standards is important in situations where context analysis does not provide a clear regulatory approach.

### *Dynamic Regulation*

Dynamic regulation requires flexible rules that are constantly reviewed as market and industry evolves. A continuous impact assessment of regulations and standards through consultations with private sectors is important for maintaining proper incentives for all actors.

### *Smart Factor Market Regulation*

Labour and capital are important factors of production. Labour, in particular, is capable of self-organizing for a share of added value that is not commensurate with its contribution. Industrial actions and politics provide labour with capacity to demand uncompetitive wages that may constrain growth of output and eventually scare away investors. Legislating too high minimum wage, for instance, may constrain proper response to market signals by employers and lead to misallocation of factors. Overpriced capital may also distort factor markets and repel investors.

### *Even Enforcement of Regulations*

A major problem in developing countries like Tanzania is poor and uneven enforcement of regulations. Poor enforcement has been mainly due to lack of regulatory capacity and corruption. Uneven enforcement distorts competition because it denies competitors a levelled playing field. In Tanzania the situation is worsened by a large informal sector operating outside the regulatory framework, which gains substantial cost advantages that offset their low productivity. The cost advantage helps the informal enterprises stay in business.

### *Protect People Not Jobs*

Beardsley and Farrell (2005) argues that instead of seeking to prevent loss of jobs eliminated through search for productivity, regulators should focus on cushioning workers losing jobs by providing 'safety nets' such as hefty supplementary compensation and opportunities for redeployment. In the short run, protecting jobs may be 'politically correct' but in the long run such a stance may lead to a costly loss of productivity and eventually loss of jobs.

### **Conclusion**

The purpose of this chapter was to review the concept and theory of economic regulation, examine the main goals of regulation and its instruments, forms of regulation, and the intractable process of striking the right balance in regulation. Striking the right balance is the main challenge in economic regulation if retardation of economic growth is to be avoided. The underlying requirements for effective economic regulation include capacity to regulate, right incentives for various actors, competence and independence of regulators. Although the focus was on economic regulation, it is important to recognize that success of economic regulation is predicated on effective regulation in all other societal activities. In particular, the efficacy of institutional framework and enforcement culture are critical in providing for effective economic regulation. Formal and informal 'rules of the game' in society have a direct effect on economic regulation.

Getting economic regulation right and enforcement are major challenges in developing countries. Analysis indicates that dynamic regulation requires flexible rules that are constantly reviewed as market and industry evolve. A continuous impact assessment of regulations and standards through consultations with private sectors is important for maintaining proper incentives for all actors.

The following final chapter links the rebalancing of public-private sector relationship with development policy making in development management. It discusses economic development as a conscious development policy effort guided by dynamic professional management dictates and practices.

### *Discussion Issues*

- i. *To what extent do you agree with the contention that economic regulation could be a "double-edged sword"?*
- ii. *How would you use the market failure concept to justify economic regulation by public authority?*
- iii. *Discuss major attributes of what could be characterized as effective regulation.*
- iv. *Discuss the main goals of economic regulation.*
- v. *Discuss the principles of getting economic regulation right.*

## CHAPTER TEN

### Changing Public-Private Sector Relationship and Development Management

#### The Setting

Economic development is not necessarily an autonomous spontaneous process. It is an outcome of a conscious development policy effort guided by dynamic professional management dictates and practices. Changing the public-private sector balance in favour of the private sector is itself an outcome of development management, such that the nature of its outcome may largely depend on approaches of development policy and management.

The purpose of this final chapter is to review synoptically the evolution of the development management profession as an instrument of socio-economic development. The review focuses on the evolution of management development paradigms from 'development administration' starting from 1955 to the current "new public management". The key argument is that rebalancing public-private sector relationship is an outcome of development management function.

#### Evolution of the Development Management Paradigm

The rebalancing of the public-private sector relationship effected through economic policy reforms has undoubtedly affected development management and policy making. The New Public Management (NPM) 'paradigm' could be considered a product of the economic policy reforms process. Consider the following evolutionary (chronological) models of development administration and depict the rebalancing process of the *Public-Private Sector Relationship* in the context of the developing countries.

##### *Model I: Development Administration (1955-65)*

The main characteristics during this period include:

- i. Traditional hierarchical bureaucratic model but with flexibility allowed to administer development projects, programs and development planning - role expanded.
- ii. Bureaucratic structures remained intact but applied to Less Developed Countries' situation for development.

- iii. Administrators go beyond law and order and policy making into issues of economic and social development.
- iv. Top-down management and administration.

##### *Model II: Development Management (1965-75)*

The main characteristics during this period include:

- i. Traditional bureaucracy reformed through organizational development (OD).
- ii. Management development efforts to adopt and strengthen management but still within the state domain only (stat-centred development)..
- iii. Development planning strengthened, legitimized, legislated and politicized.
- iv. Top-down management and administration.
- v. Hierarchy still pronounced.

##### *Model III: Decentralized Development Management (1975-85)*

The main characteristics during this period include:

- i. Decentralization model.
- ii. Local level model - from central to local level administration (to field offices).
- iii. Hiving out some responsibilities to local or field stations/offices.
- iv. Still top-down management but more spread.
- v. Development 'from below' necessitated by resource constraints at the centre.

##### *Model IV: New Public Management Model (1985-todate)*

The main characteristics during this period include:

- i. Intersection of top-down and bottom-up development management.
- ii. Grassroots model of development management (local groups empowered).
- iii. Institutional pluralism (market institutions and forces play a larger role).
- iv. Market-based development as opposed to state-centred development.
- v. Increasing role of Non-Governmental Organizations and civil society.
- vi. Public-Private Partnerships emerging and intensified.
- vii. Inter-institutional, multi-level development strategy.
- viii. Gender rebalancing.
- ix. Technocracy; professionalism and technocrats rise above water.
- x. Political and economic democracy valued and instrumental.
- xi. New pragmatism as an overriding paradigm.
- xii. Competitive bureaucracy, meritocracy and customer orientation.

This chronological process could be characterized as a shift from *state-centred* to *society-centred* development management. The underlying rationale for the changes is the need to enhance *economic efficiency* and *public policy effectiveness*.

### The New Public Management

According to Manning (2001), New Public Management (NPM) is about getting things done better in the public sector. A related notion moving in tandem with NPM is the '*New Public Policy*' (NPP) which is associated with 'doing different things and fewer things' in government or under the public sector. NPP involves 'slowing down or reversing government growth and privatising previously publicly provided services' (p299). According to Overman and Boyd (1994) as cited in Gow and Dufuor (2000), 'philosophical roots of NPM are those of *pragmatism*, which maintains that truth is always contingent and evolving, being tested in the real world of practice' (p581).

The following five dimensions are common in the definition of NPM:

- i. The object of NPM is the management of *public organizations*.
- ii. NPM is applied and normative. It involves value judgements, rules and prescriptions.
- iii. NPM is inspired by private organizations' management values and practices. Decision criterion is the optimal use of resources rather than respect of rules. It is driven by pursuit for "value for money" and is *result* rather than *process* oriented.
- iv. The focus of NPM is on the public manager as a practitioner of the public administration profession.
- v. NPM is prescriptive, and hence political, because many prescriptive managerial functions are political. Hood (1991) calls NPM a *doctrine* while Pollit (1990) views it as *ideology* (cited in Gow and Dufuor, 2000:581).

According to Osborne and Gaebler (1993) cited in Raymond Saner (2001), key features of NPM are:

- i. Catalytic government – steering rather than rowing (government that is proactive, no reactive);
- ii. Community-owned government – empowering rather than serving (citizens as self-directed, autonomous persons rather than as dependent and non critical subjects);
- iii. Competitive government – injecting competition into service delivery (breaking inefficiencies of public monopolies);

- iv. Mission-driven government – transforming rule-driven organization (fixing performance targets more important than being preoccupied by rules and regulations in countries with clear and established legal practice);
- v. Result-oriented government – funding outcomes, not inputs (moving away from input funding to output target funding);
- vi. Enterprising government – earning rather than spending (moving away from end-of-year spending pressure to global budgets);
- vii. Anticipatory government – prevention rather than cure (prevention cheaper than crisis management);
- viii. Decentralized government – from hierarchy to participation and team-work (new information technology [IT] demands flexible and autonomous work organization); and
- ix. Market-oriented government – leveraging change through the market (transparency regarding public procurement, non-discrimination of suppliers).

NPM type civil servant should have ability to define strategic goals and programmes, to allocate resources according to defined and agreed goals, and to guide and control the public administration in a goal-and result-oriented manner. Furthermore, an NPM government official should be able to:

- i. Identify citizen or customer needs and to communicate actively with his/her citizens;
- ii. Include politicians in the management process;
- iii. Assist political decision-makers in strategic thinking;
- iv. Motivate and empower his/her team of civil servants;
- v. Innovate through experimentation and reflection; and
- vi. Have the capacity for learning;
- vii. Direct the administration in its effort to be competitive in its market;
- viii. Establish an organizational culture with a distinct service orientation.

Leadership in this context is moving toward a convergence with the business leadership model. Instead of rule by the book, public servants will have to rule by vision, by reasoning and by collaboration.

NPM is not necessarily one "coherent whole" paradigm; it is rather "a menu of choices than a single option" (Gow and Dufour, 2000). The various options fall under the following two categories:

- i. Management culture and orientation, which emphasise the centrality of the citizen or customer and accountability for results.

- ii. Structural or organizational choices: 'Decentralized authority and control, with a wide variety of alternative service delivery mechanisms including quasi-markets with newly separated service providers competing for resourcing. Market orientation is underlined by emphasis on cost recovery and competition between private and public agencies for the contract to deliver services' (Manning, 2001:299). They include also establishment of "executive agencies".

The post-bureaucratic framework presented in the table 10.1 below reflects the broad philosophy and scope of recent reform initiatives based on the New Public Management (NPM). It outlines the major elements of the NPM. The framework takes account of several models of public organization and management, including the market and participatory ones. The primary means by which public organizations can move towards the post-bureaucratic model have become well known to the public administration community over the past few years. They include *partnerships, empowerment, restructuring, re-engineering, information technology and continuous learning.*

Table 10.1: Comparing Bureaucratic and Post-Bureaucratic Organization (New Public Management)

Characteristics of the Bureaucratic Organization	Characteristics of the Post-Bureaucratic Organization
<b>Policy and management culture</b>	
Organization-centred <i>Emphasis on needs of the organization itself</i>	Citizen-centred <i>Quality service to citizens (and clients/stakeholders)</i>
Position power <i>Control, command and compliance</i>	Participative leadership <i>Shared values and participative decision making</i>
Rule-centred <i>Rules, procedures and constraints</i>	People-centred <i>An empowering and caring milieu for employees</i>
Independent action <i>Little consultation, cooperation or coordination</i>	Collective action <i>Consultation, cooperation and coordination</i>
Status quo-oriented <i>Avoiding risks and mistakes</i>	Change-Oriented <i>Innovation, risk taking and continuous improvement</i>
Process oriented <i>Accountability for process</i>	Results oriented <i>Accountability for results</i>
<b>Structure</b>	
Centralized <i>Hierarchy and central controls</i>	Decentralized <i>Decentralization of authority and control</i>
Departmental form <i>Most programmes delivered by operating departments</i>	Non-departmental form <i>Programmes delivered by wide variety of mechanisms</i>
<b>Market orientation</b>	
Budget driven <i>Programmes financed largely from appropriations</i>	Revenue driven <i>Programmes financed as far as possible on cost recovery basis</i>
Monopolistic <i>Government has monopoly on programme delivery</i>	Competitive <i>Competition with private sector for programme delivery</i>

Source: Kernaghan (2000) *International Review of Administrative Sciences*, 66 (1):92.

## The Emerging Consensus in Development Management and Administration

According to Esman (1991), there is an emerging broad consensus that priority must be assigned to addressing the critical internal *problems of economic policy and management*. The economic agony of the 1980s characterized by declines in living standards in many LDCs has led to 'new pragmatism' in which there is an increased willingness among participants and analysts to address economic performance of the state as an empirical question (not to be deduced from theory) that may vary from country to country and even with successive regimes in the same country. As Esman (1991) puts it:

*Where empirical evidence highlights incompetence or resistance to economic rationality, the presumption is to seek and develop competence outside government, in market processes or in local and voluntary associations. Where governments manifest integrity and ability, they can safely be entrusted with a wide range of responsibilities. Choices regarding governmental regulation or participation in economic activities and relations between the state and markets are to be made at the margin in response to pragmatic judgments, rather than as deductions from absolutist ideological positions (p12).*

It is further argued by Esman that the:

*extravagant claims of the ideologues on all sides [capitalist and socialist] have broken down in their confrontation with the complex reality of development. This reality has highlighted not only the limitations and dysfunctions of governments, but also the simultaneous fragility of markets and private economic initiatives and the weaknesses of local associational capacities when confronted with the challenges of economic stagnation ... Sustained action oriented to economic development requires continual exchanges [partnership] between the institutions of state and society ... interdependence of governments, markets, and voluntary action (p12).*

In essence, Esman argues that the relationship between state and societal groups (civil society) should not constitute zero-sum competition, but rather complementarities that have to evolve in specific patterns for each sector or social and economic activity. Market institutions, government institutions, and community institutions need to be activated and strengthened while supportive linkages among them have to be shaped and cultivated.

## Conclusion

This final chapter reviewed the evolution of development management profession as an instrument of socio-economic development. The focus was on the evolution of management development paradigms from 'development administration' in the 1950s to the current New Public Management (NPM). It has been shown that rebalancing of the public-private sector relationship is an outcome of development management function.

Rebalancing of the public-private sector relationship effected through economic policy reforms has undoubtedly affected development management and policy making. The New Public Management (NPM) "paradigm" could be considered a product of the economic policy reforms process. Economic development is not necessarily an autonomous spontaneous process. It is an outcome of a conscious development policy effort guided by dynamic professional management dictates and practices. Changing the public-private sector balance in favour of the private sector is itself an outcome of development management, such that the nature of its outcome may largely depend on approaches of development policy and management.

## Discussion Issue

*To what extent is the rebalancing of the public-private sector relationship affecting public administration and development policy in Tanzania?*

## APPENDIX

### Case No. 1

Theme: Strategies for Rebalancing Public and Private Sector Relationships

#### **Tanzania Harbours Authority Reveals Privatization Options\***

Consultants appointed to propose the best options to run the Tanzania Harbours Authority (THA) have recommended that it remains a parastatal enjoying a "landlord port" status.

The experts have also recommended that the authority's 14 business activities be privatized with different options for each entity. It is recommended that the container terminal be given to a private operator under a long-term concession. A consultant has been picked to carry out a valuation of assets, prepare the legal aspects of concession, and draft a concession agreement and invitation to bid documents.

Several options have been identified for the privatization of the general cargo terminal, including open access to any of the berths for any licensed cargo handling company. Also recommended are the subdivisions of the general cargo area for leasing to private operators. The consultants have also proposed the creation of a single THA cargo handling company, to be privatized at some future date.

The other option recommended is the sub-division of the terminal into two units, with one unit being subdivided further into private terminals. The other unit would continue to be under THA but subject to open access. It is recommended that the grain terminal be leased or concessioned and the passenger terminal privatized.

The latter terminal includes the Maritime Training Institute and the Marine Policy jetty. It is recommended that it be privatized on a "build, operate and transfer" (BOT) basis. It is also recommended that the oil jetty be retained under a new, downsized THA and managed by a committee of all users to ensure efficiency.

The recommendation with regard to marine services is that a vessel management contract should be prepared to guide the contracting out of crewing and port

\* Adapted from Financial Times, September 30th, 1998

vessel operations. Another privatization option recommended is the franchising of marine services.

A single private company would be licensed as the sole supplier of services on payment of a royalty to THA or on a revenue sharing basis. It has been revealed that the option recommended for the divestiture of THA maintenance facilities is to have them remain under a new-look authority, with some of its services contracted out.

Privatization options for the Mtwara and Tanga ports are to resemble that of the general cargo terminal in Dar es Salaam. Other privatization options have been recommended for minor ports, medical services and facilities as well as real estate. These should support activities like warehouses, residential property and commercial property.

Implementation of the new strategy is said to have begun, with the container and grain terminals singled out for immediate privatization.

#### **Build, Operate and Transfer: How to Adapt the Idea to Tanzanian Conditions\*\***

One among the ideas being floated for extending private sector activity in the economy is allowing various firms to engage in what is normally termed as Build, Operate and Transfer (BOT), where private investors are commissioned to undertake such works in anticipation to resell (or transfer) the facilities to the government at a future date. The idea may be sound as it stands, but it is not clear how it is applied in various circumstances.

To find out whether the idea is relevant for a situation like Tanzania, perhaps the question that needs to be asked is how far such a project would need supporting finance from the government, obtain direct set up and operational guarantees, and then be assured an income to become a viable project. If that was the case, the difference between the government putting up a project isn't noticeable from such a BOT idea.

Were it assured that the individual investor or a consortium of investors would only seek permission from the government to put up a specific facility, raise all the

\*\* Adapted from Nimwi Mweta in Financial Times, May 27th, 1998

cash required and then start operating in a strictly commercial context, in competition with any other existing facilities, the idea could be welcome. The only snag is whether there would still be any relevance in the facility then being 'transferred' to the government.

In sum, there are two or three aspects forming one generalized idea, and perhaps these need to be picked up one by one, disaggregated the way the Reagan Administration split up the idea of a collective Third World in the early 1980s. The first point is 'build' where the private sector is simply allowed to come up with any facility it finds relevant to the economy, without firstly being asked to do so, which is clearly a good idea.

The second idea is that of operating such a facility once it has been built, which follows early from the first, in that if it was possible for someone to come up with an idea and mobilize the financing, then it should be able for the same persons to operate the facility and make a profit from it. But as if this was a sin, the process is supposed to stop at a certain point in order for it to be transferred to the government.

This is the snag, that at the end of the BOT, both of which are positive ideas, there is the third aspect, "transfer", which sort of promises to undo the original idea behind the other two components of the BOT idea. For, in the first place, the government has been seen to be incapable of building, and those buildings it held and operated as public infrastructures have by and large crumbled; why should new ones be transferred to it?

There is a lot of reason to believe that the final 'transfer' to the government is only dictated by ideology, that the notion of 'build, operate and transfer' was coined at a moment that liberalization was making its entry in the West, after two decades of Prof. John Maynard Keynes, where it was upon the state to collect the necessary sum to invest in the infrastructure. It was a positive move, but still way off real liberalization.

The idea presumes correctly that individuals can actually embark on the construction of vital public facilities, including for that matter infrastructural projects like roads, railways, bridges, or any facility that needs an investment and can be designed and constructed. The difficulty is that all these areas are in theory still the preserve of the government, which means that the investor is really assisting, not replacing, the government.

One can't be so sure if this ideology is still operating in the West, or it has already been taken over by a liberalization of the ownership of the facilities themselves, removing the necessity to transfer any such facility as if it was iniquitous for private individuals to run it. Once they are able to build and operate, why is it that they should not continue to run it after recovering their initial investment, or with a minimum of royalties?

While it is disputable if a facility that has been entirely conceived, built and started being operated by the private sector should be transferred to the government, it is an altogether different matter when a project of the sort is actually being constructed so that it is later transferred. When private operators are keenly aware that they are merely assisting the government, and the latter provides the conditions, is it still private?

One of the difficulties of the Independent Power Tanzania Limited (IPTL) Project is that, right from the start it was based on the wish to obtain more electricity for connection to the Tanzania Electrical Supply Company (TANESCO) grid, and on that basis the latter provide all the guarantees as to building and operating the facility. In the BOT logic, the latter would then be transferred to TANESCO after it had recovered the minimum costs and some profit, though the idea here was different.

Had the project been required to at least rely on its own financing and ability to operate, in competition with whatever other electricity suppliers there were (if Songas, Kihansi and the rest wouldn't just be TANESCO inlets), there would have been little controversy about the rates it would have to charge consumers. In any event, it would probably charge the 10 to 12 US cents envisaged, not the 20 to 25 US cents TANESCO might charge.

There is a distinct advantage when the project is not tied to a parastatal or the government at its initial stages, up to construction and operation, which on the whole is assumed in the BOT idea. The question or rather the point of difficulty is that this may visibly remain the case in the more advanced states, where the conditions of profitability are generalized for the entire economy, without discretionary options like it is here.

Were a scheme of the sort to be started here, of whose best example is again the Independent Power (T) Project scheme, where the government underwrites the choice of technology and operating costs, there wouldn't be much difference with an ordinary public project, save for the extent to which it could be used to channel public resources to fund a scheme tied to a few individuals. Only in the absence of public fund can efficiency be expected, in sum.

Building an infrastructure project should be encouraged like any other investment, and just as it is not expected that a company constructing a textile industry at the moment is at a future moment likely to transfer it to the government after recovering its costs of production, so should it be the case if a firm gets a portion of the harbour to improve and manage. There is nothing strange about a private wharfage unit.

If the facility to build and operate public facilities is generalized, it could help the country resolve so many of the bottlenecks now dodging production and productivity generally due to the inability of the state to fund or maintain many of the facilities it holds as a monopoly. And there is no need to go just halfway into the matter, by a build, operate and transfer method, instead of entering into head-long liberalization in services.

Where a private investor has government guarantees from the start he turns into a speculator and not an investor, in the sense that he no longer takes real risks since someone else (the taxpayer) shall be carrying the burden for him. This is, for instance, what is wrong with Independent Power (T) Project, a private power scheme where the government, through Tanzania Electrical Supply Company (TANESCO), must purchase 80% of what it generates, whether it needs the supply or not.

In developed economies, where the state of the infrastructure is already as good as it can possible be and where no project in particular is direly needed by the public, such a public facility project becomes a good idea only in the sense that it is given a licence the way the Tanzania Investment Centre (TIC) okays a project. But it is not the TIC, which is asking someone to build such a facility and then guarantees success of the project.

This is precisely what you find in the case of infrastructural projects where the services are sorely lacking, in that the investor finds himself a partner of the government right from the start, not a private developer who puts up a private facility which may in future be of some interest to a local council or even the central government – in the sense of a federal agency for instance in the USA. Instead, the state is always part of it.

Having the government form an integral part of any investment is a prelude to inefficiency, since it removes the rationale for the private sector initiative, which definitely has to do with the risks taken for using a specific amount of capital to set up a particular project. There has thus got to be a separation of the three components, where build and operate are distinct and private, while transfer is hypothetical and optional.

While it can be envisaged that in a situation where bridges are the property of the government, someone putting up a bridge would be expected to transfer it to the government someday, it can also be demanded whether such a person wouldn't just qualify for a road toll portion, or allowed to charge a minimal sum for vehicles using the area (not 300/- each time a vehicle passes). A small annual fee for instance could do.

In Tanzania, an open example of a BOT project is the two-story extension of the Central Library building along Bibi Titi Mohamed Street, Dar es Salaam. The project was initiated by the Ministry of Education and culture and approved by the Board of Directors of the Tanganyika Library Services (TLS), which awarded the project to a foreign investor, Management Group Limited as management contractors.

The awarding followed the Board's meeting held on August is in 1994, after proving the abilities and competence of the investing company. The ministry resorted to BOT because it had no funds. Yet the library needed immediate attention since its roof was leaking threatening closure of the vital facility. The situation forced the TLS Board of Directors to offer 12 years lease free of any rent to any investor. The investor rents the added spaces, thus collecting taxes for the government and also revenue for his savings, which could be re-invested at the expiry of the lease period (Ambali in Financial Times of 28th October, 1998).

Under the BOT, private company designs the facility and the government approves it. After approval then the private firm finances its construction. At its completion, the private firm owns it for the period agreed to with the government. After expiry of the operation period the government takeover the facility in good shape.

#### *Guide to Case Analysis:*

*Considering advantages and disadvantages of the BOT, analyse the central argument in favour of the BOT strategy of privatization in Tanzania.*

## Case No. 2

Theme: Divestiture Process

### **Divestiture of PRINTPAK (T) Ltd\***

#### **Introduction**

The Presidential Parastatal Sector Reform Commission (PSRC), which is responsible for the divestiture of state-owned enterprises, had to clarify on the divestiture of PRINTPAK (T) Ltd through the following Press Release in order to put right some misleading and defamatory statements and articles that appeared in public media in regard to the divestiture of PRINTPAK.

#### **Production Performance**

Production of books declined from 3.3 million copies in 1991 to only 88,341 in 1997. While in 1993 PRINTPAK had thirty nine (39) Newspapers under its customer list, by the end of 1995 PRINTIPAK was left with only one Newspaper.

#### **Financial Performance**

PRINTPAK is one of the most indebted Parastatals. The company's disclosed liabilities amounted to Tshs. 1.6 billion as at December 1997. PRINTPAK had accumulated losses of Tshs. 951.4 million as at December 1995.

The poor financial performance of the company has been caused by a number of factors. The major problem, however, is the non payment of debts by its major customers, including the Tanzania Standard Newspapers Ltd. (Daily News), which owes PRINTPAK Tshs. 1.4 billion for the printing services rendered over a number of years.

Inefficient utilization of its landed properties, especially non payment of rental fees by its major tenants at Maktaba Street Building and its Seaview flats, has adversely affected the company. The entire first floor of the Maktaba Street Building, which belongs to PRINTPAK is occupied by the Daily News. Out of the nine Seaview flats owned by PRINTPAK, seven are occupied by the Daily News staff. For the past eight years Daily News has not paid rent for both the office accommodation and the Seaview flats, albeit the token rates of only Tshs. 124,860/= per month for the entire floor of the Maktaba Building and Tshs. 28,000/= per month for the residential flats at Seaview.

#### **Technology Performance**

The company has old technology machines, many of them are over 20 years old. For example, the Web Printing machines were manufactured in 1974. The old machines at PRINTPAK have to be replaced with modern ones, in order for it to compete in the market. The current machines are technically obsolete and would fetch very low prices if disposed.

#### **Divestiture of the Company**

PRINTIPAK was advertised for joint venture in the Newspapers. The first round of the advertisement did not attract any bid. It was after the extension of the advertisement that seven companies purchased the Divestiture Information Memorandum of the company. The companies were:-

- |                                                |                      |
|------------------------------------------------|----------------------|
| (i) Ben & Co. Ltd                              | PSRC Receipt No. 917 |
| (ii) Infotech Investment Group                 | PSRC Receipt No. 923 |
| (iii) Tanzania Printing Services Ltd           | PSRC Receipt No. 930 |
| (iv) Tanzania Standard Newspapers (Daily News) | PSRC Receipt No. 931 |
| (v) Oriental Printing Press                    | PSRC Receipt No. 944 |
| (vi) Metro Investment Ltd                      | PSRC Receipt No. 948 |
| (vii) Printpak Management & Workers            | PSRC Receipt No. 997 |

However, like many companies with old technology machines and poor financial performance, the divestiture of PRINTPAK did not attract many bid offers. The PSRC received only three bids from:

- Infotech Investment Group of Dar es Salaam
- Management and Workers of Printpak (PM & E)
- Tanzania Printing Services Ltd of Dar es Salaam.

#### **The Offers**

- Infotech Investment Group
  - Offered Tshs. 600.0 million for 75% of the shares of Printpak and also take over liabilities amounting to Tshs. 1.1 billion.
  - Proposed to invest Tshs. 2.59 billion in new machines and rehabilitation, over a period of two years.
  - Proposed to take over all employees of PRINTPAK.
- Tanzania Printing Services (TPS)
  - Offered Tshs. 794.1 million for 75% of the shares of Printpak on condition that PRINTPAK's liabilities amounting to Tshs. 1.1 billion be taken over by the Government.

- Proposed to invest Tshs. 1.29 billion over a period of five years. TPS proposed investment on a prorata basis with the Government or else the remaining Government share (25%) would be diluted.
- Proposed to take over only 40% of the workers. The rest would be terminated.
- **Printpak Management and Employees**
  - Offered Tshs. 244.9 million for 75% of the shares of Printpak on condition that the Daily News debt owed to PRINTPAK be paid by the Government after the divestiture.
  - Proposed to improve production at PRINTPAK by undertaking an investment and rehabilitation programme over a period of five years, for Tshs. 2.3 billion

#### **Bid Evaluation**

The Divestiture Technical Committee comprising membership from the PSRC, Ministry of Finance, Ministry of Industries and Trade, Planning Commission and Tanzania Karatasi Associated Industries (TKAI), analyzed the three bids, taking into consideration PRINTPAK's problems, the background and proposed business plans of the bidders and recommended that Infotech Investment Group be invited for negotiations to purchase the 75% shares of PRINTPAK.

#### **Valuation of the Company**

Valuation of the company was carried out by an independent value appointed by the PSRC. The business value of the company was estimated at Tshs. 1.8 billion. The Government is selling 75% of the shareholding of the company, therefore the estimated value for the 75% shareholding is Tshs 1.3 billion. The value excludes the liabilities of the company.

#### **Negotiations**

Negotiations with INFOTECH were held on 31<sup>st</sup> October 1997 at which the following were agreed:-

- **Shareholding**  
75% of PRINTPAK's shareholding be sold to INFOTECH and the remaining shares be sold to the public when PRINTPAK is profitable.
- **Liabilities**  
INFOTECH shall take over the company liabilities amounting to TAS 704.7 million.
- **Purchase Price**  
INFOTECH shall purchase 75% shares for Tshs. 600.0 million.
- **Investment Plan**  
INFOTECH shall invest in PRINTPAK Tshs. 2.5 billion and the investment plan shall be part of the Sale Agreement.
- **Employment**  
All employees of PRINTPAK shall be retained. In case of unavoidable termination, INFOTECH shall be responsible for their terminal benefits.
- **TKAI's two top floors**  
The ground and first floors of the main building at Maktaba Street belong to PRINTPAK. The third and fourth floors belong to TKAI. The two floors, which belong to TKAI, do not form part of this deal.
- **Prior to the signing of the Sale of Shares Agreement, the Daily News should vacate the first floor of PRINTPAK building, to enable INFOTECH to implement the investment plan.**
- **Court Cases**  
PRINTPAK has twenty one (21) libel cases in which a number of Newspapers are being sued together with PRINTPAK as their publisher, for publishing libellous articles. It is estimated that the associated contingent financial liability can be as high as Tshs 200 million. INFOTECH shall take over the Court cases and related contingent liabilities.
- **Future Sale of Shares**  
The Government will make available all its remaining shares (25%) to the general public through the stock exchange or any other mechanism deemed appropriate at the time. The remaining shares of the Government shall not in any manner be diluted during the implementation of the Investment Plan.

## Divestiture Progress

The Memorandum of Understanding (MOU) was signed on 22<sup>nd</sup> January 1998 and INFOTECH paid 10% of the purchase price as required. The investor is ready to sign the Sale Agreement and pay the balance as per the MOU. However, as a condition precedent for signing the Sale Agreement, Daily News has to vacate the first floor of PRINTPAK building, to enable the investor to implement the investment plan. Daily News is resisting to vacate the premises. This has been the major problem hindering the completion of the divestiture of PRINTPAK. Efforts by relevant Government Ministries are going on to solve this problem.

## General Information

The PSRC would like to inform the public, that the Divestiture of PRINTPAK and other Parastatals focuses on ensuring the enterprises revival and improvement of operational efficiency and contribution to the overall national economy and not only the purchase price.

Unlike auctioning, under which the price is the determinant factors, in divestitures we do systematic evaluation with attention being paid not only to estimated valuation figures or purchase prices but also to a number of other criteria as stated above. Valuations are only intended to give indicative prices. In the end it is what the investors (market) are willing to pay that counts.

The PSRC shall not allow itself to be influenced by a single factor such as the offer price or individual wishes and hope of continued free services from PRINTPAK at the expense of the company and the long-term national interest.

## Guide to Case Analysis:

*Cognizant of the problems encountered assess the process and policy implications of the divestiture of PRINTPAK (T) Ltd.*

## Case No. 3

Theme: Public-Private Partnership in Public Service

## Dar-es-Salaam Water and Sewerage Authority (DAWASA)

### Background

Dar-es-Salaam (Tanzania) water supply is under the *Dar-es-Salaam Water and Sewerage Authority (DAWASA)*. For several years now water supply and sewerage services in most parts of the City of Dar es Salaam have been unsatisfactory. This situation is attributed to several factors, namely: rapid population growth, under-investment due to adverse economic situation, inadequate operation and maintenance, old age of the existing systems, which causes losses in water and revenue.

The water supply for DSM has not undergone major investment for many years apart from the rehabilitation of the Upper Ruvu intake, treatment plant and a portion of the mainline.

The Lower Ruvu water supply system, which is the main source of water for Dar es Salaam and Bagamoyo, is more than 20 years old, while the Mtoni water supply system is about 50 years old. Consequently, these systems are now operating below their installed capacity and have frequent breakdowns and pipe bursts. On the other hand, new developed areas do not have proper distribution networks thus encouraging informal and illegal connections.

The sewerage system is inadequate; only about 10% of the population is served. Thus rest of the population is partly served by septic tanks and the majority depend on pit latrines. Furthermore, the existing sewerage treatment works are in poor working condition resulting in most of raw sewage being discharged to the ocean without treatment.

In view of the aforesaid, the Government has taken various steps to address the problem:

\* Adapted from Press Release of the Ministry of Water in Daily News, May 12th, 1999

- a) Implementing an emergency programme of borehole drilling to augment water supply and also repair of leakages in order to reduce the physical water losses.
- b) Attracting private participation in operation of water supply distribution and sewerage systems to improve efficiency, financial performance and investment.
- c) Mobilizing resources for detailed studies on water flow regulation of Ruvu River including possibility of constructing of a dam at Kidunda. Implementation based on the results from the studies will be undertaken as soon as the required financial resources are available.

### Invitation for International Water Operators

In October, 1997 the Government of Tanzania through the Presidential Parastatal Sector Reform Commission (PSRC) invited internationally qualified water operators to bid for the operational management of the DAWASA system including provision of capital finance necessary to refurbish and extend the water supply and sewerage system. Out of 16 bidders who showed interest, only five presented their formal submission, and these were:

- o Acquanova Consortium (South Africa)
- o Biwater International (UK)
- o Group Generale des Eaux (France)
- o Northumbrian Water/Lyonnaise/Brown and Root Consortium (UK)
- o Saur International (France).

Four out of the five firms, Biwater International (UK), Group Generale des Eaux (France), Northumbrian Water/Lyonnaise/Brown and Root Consortium (UK) and Saur International (France) were selected for further necessary steps so that one firm could be selected.

However, it became clear that such companies could not source concessionary funds for capital investment programme. Commercial funding would result in higher tariff for water. In view of this, the government in November 1998 decided that the mode of privatization of DAWASA should be LEASE with the possibility of concession at later stage.

### Mode of Privatization: Leasing

Under a lease arrangement the private operator leases the assets of the utility from the Government and takes on the responsibility for operating and maintaining them. The private operator assumes much of the commercial risk of the operations since it essentially buys the right to the income stream from the utility's operations and only pays a mutually agreed lease fee. Ownership of assets and the responsibility for planning investments and financing remain with the Government. The Government, therefore, takes the risks associated with capital investment. However the Government is able to source concessionary financing for investments for major donors. In this way, lower tariff can be maintained as compared to commercial financing.

### Institutional and Legal Reforms

In February 1999 the Parliament passed a bill to amend the DAWASA Act of 1997 so as to create an enabling environment for the private operator to function. In the new revised an Act, the existing DAWASA will be split to form a Public Granting Authority (PGA) and a Private Operator (PO). The PGA will be the DAWASA Asset Holding Authority which will lease the assets to the Private Operator. The PGA will be responsible for funding the bulk of the capital programme and will consider and approve the strategic business plans and annual investment plans prepared by the Private Operator. The major task of the PGA will be to secure funding for the operation of the water supply and sewerage services in the DAWASA Designated Area and will therefore be required to provide the working capital.

In the same Act, a Water Regulator will be appointed for the DAWASA Designated Area. Part of the functions of the Water Regulator will include:-

- o Licensing and regulatory function in respect of water supply and sewerage services including the establishment of standards.
- o Providing guidelines on tariffs chargeable for provisions of water supply and sewerage services.
- o Examining and approving tariffs.
- o Protecting interests of consumers and water operators.
- o Monitoring of water quality and standards of performance.
- o Initiating and conducting investigations in relation to standards of quality of service given to consumers.
- o Promoting fair competition among water operators.

## Capital Investment Programme

In order to solve the problem of water supply and sewerage services for the DAWASA Designated Area, a total outlay of US\$600.0 million will be needed. The execution will be in four phases: immediate, short, medium and long terms phases.

In the immediate works programme the investment requirement is estimated at US\$117.0 millions. A number of bilateral and multilateral agencies have indicated their commitment to support the programme. They include the World Bank, Africa Development Bank, the European Investment Bank and the Agence Francaise de Development (AFD) of France.

The immediate works programme will include rehabilitation of power transmissions lines, rehabilitation fund and sewer systems. The package will also cover extension of distribution mains and tertiary distribution systems.

In the medium and long-term programmes new water sources development, including regulation of the water flow in Ruvu River, will be developed to cater for future water demands for the Dar es Salaam area to ensure availability of water.

### Conclusion

The Government is highly desirous that all necessary actions will be taken to ensure that the Private Operator is selected by end of 1999 and that the will have started work by January 2000. It is also expected that the required funds for the immediate works programme will have been mobilized from the various international financing institutions so that the Rehabilitation works can start by the time the operator is in place.

### Guide to Case Analysis:

*In the context of the political economy of rebalancing the Public and Private Sector Relationships, assess the strategy of privatization adopted in the above case.*

## Case No. 4

Theme: The Process of Rebalancing Public and Private Sector Relationships

### Should the Parastatal Sector Reform Commission be Blamed for Slow Privatization?\*

Recently there has been a public outcry about the dilapidated state of companies earmarked for privatization, which have degenerated and appear like abandoned warehouses. The companies awaiting privatization for over five years now have had their assets neglected for lack of regular maintenance and disuse to the extent that potential investors would be led to believe what they were buying was the land and not factories. Vandalized equipment, machinery and buildings, which have not been maintained, are not likely to attract potential investors.

The Vice President has correctly castigated this neglect of public assets especially when we consider that we invested at a rate of 20 per cent of GDP annually in public enterprises in the era before privatization was ushered in. When the Parastatal Reform Act was passed in 1992, it gave the Parastatal Sector Reform Commission (PSRC) the mandate to oversee the whole process of divestiture of public enterprises from evaluation of assets to tendering, while the final decision was left with the cabinet. It is, however, difficult to single out the PSRC as the only culprit for the slow pace of privatization when so many other institutions are involved.

There are too many players in the Technical Divestiture Committee which include company boards, holding corporations, parent ministries and the Commissioner for Public Investment in the Ministry of Finance. This is what has introduced bureaucracy in the whole privatization exercise since it started in 1992. In addition, there have been litigations by workers unions and other citizens as well as court attachments of company properties even after sales agreements have been signed with strategic investors, thus delaying divestitures.

The Morogoro Canvas Mill is one such publicized case where workers compensation and terminal benefits had not been resolved before the sales of the company was decided, leading to the current stalemate. Many companies were faced with this problem including State Travel Services, Steel Rolling Mill, Tanzania Cigarette Company, Moshi Hotel and others. In other cases, there have been appeals from those who have lost out in the privatization tendering process, which have been entertained by some government officials.

\*Adapted from Editorial Opinion of the Daily News, December, 10<sup>th</sup> 1998

A classical case is that of Kilimanjaro Hotel. The bidder who met most of the PSRC specified criteria was not awarded the tender promptly and the prolonged negotiations and re-negotiations after tender evaluation have led to the present state of abandoned hotel which lacks the facilities of a five star hotel due to the prolonged uncertainty about its future.

Kilimanjaro Textile Corporation had all its assets vandalized and stolen because of lack of security. As a result, it has degenerated into blocks of warehouses, which cannot qualify as a factory worthy of investment.

The 1992 Parastatal Reform Act should have specified who would be responsible for looking after the assets of the companies earmarked for privatization until they are either sold or a decision is made to liquidate the companies as separate asset components.

Most of the parastatals had huge debts to the government and private companies. Two cases in point are Ploytex in Morogoro and Southern Paper Mills which owe TANESCO colossal amounts in unpaid electricity bills.

The government needs to make clear policies in such areas as employee safety nets, Privatization Trust Fund, management buy-outs, role of holding corporations, debt forgiveness and retrenchment of workers in the companies being privatized.

Would it not be proper and logical to use part of the fund from proceeds of companies' divestiture to pay-out all retrenched workers and overcome resistance to privatization?

The government should also make conditions of sale of parastatals less stringent. These have included obliging buyers to continue to produce the same products and sometimes to retain the workers and inherit the debts of the companies being privatized.

PSRC is but only an overseer of the privatization process. Bureaucracy and too many vested interests among some government officials should also be tackled so that privatization is not delayed and public assets are not left to deteriorate to the extent of losing their commercial value.

It is not yet too late to develop strategies which will preserve the remaining public assets before they are privatized. The Treasury Registrar who is also the Commissioner for Public Investment, is the custodian on behalf of the people of the investment in state owned enterprises.

It is high time the Treasury created a fund from the privatization proceeds or other sources which will be used to maintain in good condition even those enterprises which have been mothballed so that they will attract buyers who will pay good prices for them.

It is also pertinent to re-examine the need to have the Divestiture Technical Committee, whose abolition would turn PSRC into an autonomous privatization agency which would then be held accountable for the slow progress in privatization after ministries and holding companies have been removed from managing the privatization process.

Of utmost importance is to have policies which encourage investors in companies which are being privatized. So far, very few companies in the textile sector have been privatized because of the vulnerability of the sector to disadvantageous competition from imported textiles and garments. Fiscal incentives which give preferential treatment to this sector will certainly make it more attractive to investors who intend to buy the former National Textile Corporation (TEXCO) companies. These proposals, if translated into concrete policies and strategies would speed up the pace of privatization which should include provision for immediate liquidation of those public enterprises which proved unsaleable as going concerns.

#### State Adopts New System of Privatization\*\*

The government has introduced a "fast track arrangement" aimed at speeding up the process of privatizing parastatal organizations, it has been learnt. The Minister of State in the President's Office (Planning) told the Daily News that the arrangement shall, among other things, remove from the Parastatal Sector Reform Commission (PSRC) the burden of processing the divestiture of all parastatals in the country.

The Minister said the "fast track arrangement" team is chaired by the Prime Minister and involves ministers and technical staff of parent ministries under which the respective institution earmarked for divestiture falls. The Minister said the team would make decisions on such parastatals and inform the government on the sale contracts. The minister said some of the parastatal organizations listed in the PSRC action plan did not warrant the vigorous process through the commission to privatize them.

\*\* Adapted from Charles Kizigha, in Daily News, December, 16th 1998

The Minister added that some of the institutions do not require experts to study their documents and negotiate with the prospective buyers. For example, he explained, regional trading companies (RTCs) under the Board of Internal Trade (BIT) are almost dead as they no longer conduct business. All that they have been left with are godowns and houses. Such companies can be privatized by allowing the workers to buy shares in the individual companies, but it must be ensured that the government realizes its due money from the assets. Such firms can be dealt with under the "fast track arrangement". The Board of Internal Trade has put up a proposal encompassing some profit-making trading companies under it which have formed companies whose workers would buy shares.

The Minister said his ministry and PSRC will only advise in processing the privatization of the BIT Group companies according to the recommendations made by the Ministry of Industries and Trade.

On utility parastatals, the Minister said modalities for divesting them were underway and steps have already been taken to leave the institutions with only core operations and the rest will either be sold or leased. The utility parastatals include the Tanzania Harbours Authority (THA), Dar es Salaam Water and Sewerage Authority (DAWASA), Tanzania Railways Corporation (TRC), Tanzania Electric Supply Company Limited (TANESCO), Tanzania Telecommunication Company Limited (TTCL), Air Tanzania Corporation (ATC) and the National Bank of Commerce (NBC).

### **Guide to Case Analysis**

*In light of the problems implied in this case, what is "new" in this process.*

## **Case No. 5**

**Theme:** Indigenization and Rebalancing Public and Private Sector Relationship

*To date (November 2001) out of a total of 326 privatized State-Owned Enterprises (SOE), 122 are owned by Tanzanians and 190 SOEs have been divested on joint-venture mode between the government, foreign investors and local investors. Tanzanians have also acquired 81 out of 83 assets of the SOEs sold so far (Statement by Minister of State in the President's Office for Planning and Privatization, in "Privatization in Tanzania", Newsletter, Issue nr. 08, November/December 2001).*

### **Economic Democracy in the Horizon\***

The Tanzanian Minister for Industry and Trade has heralded what he described as "economic democracy", saying the current economic system does not offer equitable opportunities for all. "We have gained political democracy... We are now looking for that economic democracy... This is because not everybody has equal rights to participate fully in economic activities", said the Minister at a packed news conference in Dar es Salaam.

In his 1999/2000 budget speech last month, the Minister had told the National Assembly that fewer than six individuals had a monopoly over Tanzanian business. He said yesterday that the third phase government was keen on addressing the ills of the past and create a set of conditions under which the marginalized will be accorded the opportunity to alleviate themselves from the disadvantageous position that the government's past policies put them in.

The Minister further said that "Contrary to what many may think, this administration does have moments of introspection when we ask ourselves, have we embraced free markets and capitalism without thinking about what will happen to those who cannot survive under such a system?" He said the situation whereby the majority were marginalized in their own economy while a small section of other Tanzanians and foreigners benefited was deeply rooted in history. He said that the government had decided to revitalize its efforts to give the majority chances to develop their lives and take control of their future.

\* Adapted from Guardian Report in the Guardian, August 15<sup>th</sup>, 1999

The Minister said that the government would invigorate the Small Industries Development Organization (SIDO) and the National Development Corporation (NDC) to economically empower the majority of Tanzanians who are sidelined in their own economy. He named some of the financial institutions ready to offer loans as the Social Action Trust Fund, Venture Capital Fund, Pride Tanzania, and National Income Generation Project (NIGP), Poverty Africa, National Micro Finance Bank (NMB) and the Postal Bank.

### **Minister Allays Fears of Racism in Privatization\*\***

The Tanzanian Minister for Industry and Trade allayed fears that indigenization is rooted in racism, saying the policy is a cure for the existing volatile social divisions on the basis of class, income and labour. "The principle of indigenization in Tanzania ... or to use a more palatable mantle... economic empowerment, was born from a sense of benevolence, not racism" the Minister told a packed news conference in Dar es Salaam.

The Minister said that a growing gap between successful owners and investors, and an underclass, whose prospects look extremely bleak, existed in Tanzania as in many other parts of the world. "We have turned our backs on the state ownership of the means of production... but we face the real danger of concentrating too much wealth and ownership in the hands of few privileged individuals", The Minister said, stressing "This is bound to lead to feelings of animosity from the 'have-nots' who are driven further and further into poverty as this disparity widens. This is a fact borne by reality and not racism".

The Minister said that the current socio-economic position that Tanzania faced today was both unhealthy and dangerous because of the disparities in wealth. "Who are we to blame from this alarming situation?... Who we should not blame are the non-indigenous Tanzanians and indeed non-Tanzanians who have been able to prosper in the country", he said.

Clarifying, the Minister said that indigenisation as a policy was not new to Tanzania as it had started with the Arusha Declaration in 1967. "I repeat, the Arusha Declaration recognized the fact that many Tanzanians were extremely poor individually to participate meaningfully in the productive areas of our economy", he said. He said that the then leadership had found it necessary to secure the involvement of its citizens in economic activities through state intervention by nationalizing all major means of production.

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\*\*Adapted from Fumbuka Ng'wanakilala, reporting in *The Guardian*, August 15<sup>th</sup>, 1999

"The post Arusha Declaration period witnessed the growth and emergence of many non-indigenous Tanzanian entrepreneurs as a result of the government of the day's policies", he said. "This happened in the absence of indigenous entrepreneurs who were more conspicuous to the attention of the state and were prevented from developing themselves as a result of an ideological principle".

The Minister said further that the indigenization policy did not mean that the government would stop the further progress of any individuals as a means of bringing up others, adding that the government believed in the maximization of the use of everybody's capacity to develop. "We need to put aside the feelings of anger and fear, suspicion and mistrust that this topic seems to evoke, and view the principle of indigenization with level headedness and a degree of compassion", he said. The Minister explained that indigenization started after the privatization of public enterprises where it was justifiably felt in some corners that the process was not benefiting all Tanzanians.

### **Indigenization Tied-up with Races, Nurtures Illusions\*\*\***

Remarks made a few days ago by the Tanzanian Minister for Industry and Trade at a major function of the Confederation of Tanzania Industries (CTI), suggested in particular that indigenisation should not be confused with racism. He explained generally that racism would be to wish to replace the Asian Community (its role in the economy) rather than merely uplifting the African part of the national community as in the indigenisation demands.

In previous remarks before the National Assembly, the Minister had outlined plans for this economic uplifting, where he particularly directed aspiring entrepreneurs to get loans from the Small Industries Development Corporation (SIDO) or seek project ideas from the National Development Corporation (NDC). A few newspapers followed up this directive and found out that the two parastatals aren't ready for this programme.

Neither SIDO nor NDC are ready to contemplate an avalanche of applicants for loans, nor lay out strategies for hundreds and even thousands of new industrial projects in the wake of the Minister's call. If in fact the Minister issued the appeal in his capacity as sectoral minister, and thus in a way these suggestions are supposed to be carried out by the concerned agencies, it would be another case of shooting before aiming.

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\*\*\*Adapted from Opinion of Guardian Correspondent in *The Guardian*, August 24<sup>th</sup>, 1999

The Minister made an effort to distinguish between the need to uplift the African community and any opposite wish to undo the dominant position of the Asian community. Yet in all his remarks it would appear that his refusal to go the whole way to remove the Asian community is merely an after thought, which does not correspond to the gist of the very notion of indigenisation, i.e. to ensure control by indigenous Africans.

Especially when the Minister alludes to the proximity of his call with the Arusha Declaration the pieces fall into place. The indigenisation is a serious idea only when it seeks to remove Asians from controlling the economy and give this position to Africans. Obviously the Minister won't say anything about the Ugandan experience under Iddi Amin, with his brutal 'indigenisation' programme where shops were handed over to army corporals who proved singularly inept to run them.

Discovering indigenisation not in 1965 but as we prepare to enter the new century (leave aside the millennium) is something close to a joke, of an idea that is about 35 years late, or time barred. As an economic model that needs a lot of state intervention, it closely resembles the Arusha Declaration with its state-backed ventures, enjoying 'ruzuku', now gone.

At the same time, the Minister should learn a few things from the South African experience since 1994. Merely owning an enterprise does not guarantee success, and indeed the challenges start at that point where the Africans – with a consumptive agenda, not a burning spirit of enterprise – will mostly fail if they are cast into a competitive market.

Going for a state-directed redistribution of enterprises (as different from incomes) to African people would of necessity carry the onus of protecting these firms from failure – and without an entrepreneurial spirit and 30 more years of aid to these 'infant' indigenous industries, will they remain in the market in five years from next year?

That is why the Minister needs to be advised to direct energies to improving productivity generally as well as to ensure the free flow of commodities so that local Africans have access to more or less the same household items that they use in Europe and South Asia. The question isn't one of owning the firms but of having access to these commodities, that people have better lives even with immigrants running the industries.

Incidentally, why is all the fuss directed at owning shops and factories rather than executive mansions and four wheel drives, about which there is no such tell-tale division with Asians having the lion's share of both?

#### **Guide to Case Analysis:**

*In the context of rebalancing public-private sector relationship, assess the merits and demerits of the various views in the indigenization debate.*

## Case No. 6

Theme: Political Economy of Rebalancing Public and Private Sector Relationship

### **Privatisation and Corruption in the Transition Economies\***

*"If you think privatization is corrupt, try without it"*

This was the response of a Ukrainian official to the 1994 parliamentary effort to halt continued privatizations on the grounds of corruption.

Governments of virtually all the transition economies in Central and Eastern Europe and the former Soviet Union have recoiled amid charges of rampant corruption accompanying their privatization programmes. Critics charge that privatization has prompted the greatest official crime wave in recorded history.

But defenders contend that privatization promises to curb the official lawlessness characterizing the transition economies since before their independence. Which view is right? Has privatization been a mistake? Should the transition economies have waited, enduring a few more years of socialism and central planning, with their discipline and enforced law and order, in exchange for a more methodical transfer of wealth from the state to the people?

One inarguable fact is that the scale of privatization in the transition economies is unprecedented. During the 1980s, about 6,000 firms were privatized throughout the world. From 1990-95, well over 50,000 medium and large-scale enterprises were privatized in the transition economies alone. These figures exclude the myriad shops and other small-scale enterprises privatized – over 75,000 in Russia, 35,000 in Ukraine, and 22,000 in the Czech Republic.

It is also true that during the same period, corruption has grown to historic levels in the transition economies. A recent survey in Ukraine, for example, indicates that the bribe demanded for installing a telephone reached almost US\$900 in 1996, and the typical border-crossing for a tradesman required a US\$200 "facilitating payment". A recent Reuters story quotes Russia's acting Prosecutor General as saying that at least 100 people with criminal records were running for parliament in one recent election. The laws in Russia granted Duma deputies immunity from jail.

Adapted from Business Times Reporter, January 28<sup>th</sup>, 1998

Many observers have connected these two dramatic threads and concluded that the only real achievement of privatization has been to institutionalize outright theft and other forms of official corruption. One academic argued that Russia's mass privatization programme, "far from creating a whole country of capitalists, or even a big class of small owners, seems likely to serve as convenient way... to launder frequently ill-gotten gains." Recent informal surveys of international experts and government officials working in the region echo the belief that privatization programmes are corrupt.

For most transition economies, there wasn't much choice whether or not to privatize immediately. Corruption is an outgrowth of broad historical, cultural and economic factors and had become endemic in the transition economies well before formal privatization programme began. While corruption may have infected privatization, as it has other government activities, delaying privatization would not have reduced corruption. If anything, corruption forced the reformers into embracing privatization to block the rapid accumulation of stolen wealth – as well as more worrisome accumulation of political power that comes with wealth – by the emerging "nomenklatura".

If pursued in conjunction with the other two central pillars of economic reform – stabilization and liberalization – privatization can reduce official corruption, which would include outright theft by government officials as well as bribes or kickbacks extracted by same officials from private entities, in return for government licences or concessions. Privatization reduced opportunities for theft of state assets, as well as the ability of politicians to extract bribes. It helps to create a political constituency, which can ally with reformists to minimize new opportunities for influence peddling by politicians. Moreover, experience is beginning to show which strategies are more likely to be associated with lower corruption in the post-privatization era. Thus, privatization, far from acting as the incubator of corruption, may be the most promising lifeline to restoring law and order and legitimate government. Studies show that faster privatization slows growth in the "black" or unofficial economy.

The main privatization techniques employed have been: voucher-based mass privatization, in which the government gives away or sells (for a nominal price) vouchers to the general population for use to purchase shares in a multitude of companies; trade sales and international tenders, in which controlling block shares are sold in individually negotiated, case-by-case transitions to strategic investors; initial public offerings, through equity offerings on the domestic capital markets – known in some countries as "capital market transactions," management and

employee buyouts, in which enterprises are sold or given away to insiders, often with payment in the form of vouchers of deferred payment arrangements to address the problem of a lack of capital liquidity in the purchasers; and liquidation, in which insolvent enterprises are disassembled and systematically sold off as individual assets.

Any of these methods can be implemented corruptly or honestly. The potential for corruption in a given privatization method is a function of how many control rights – or rights to decide how to use an asset – are retained by the politicians. This is because corrupt politicians can sell their rights or manipulate them for their own interests in a process economists call “collecting rents”.

The following factors influence how susceptible a given privatization technique is to rent collection:

- **Speed.** When large amounts of property pass through the privatization process quickly, there is less time to arrange corrupt transactions or exercise control rights.
- **Administrative Discretion.** This is the essence of control rights. Every point in the process of privatization, which requires an official signature, is a potential tollgate for corruption.
- **Information Quality.** Like other forms of illicit behaviour, the translation of control rights into corrupt side payments is facilitated by secrecy.
- **Independent Administration.** When a new implementing agency oversees the transfer of ownership, with professional, well-supervised staff, it becomes more difficult to exploit old, corrupt relationships or to establish new ones.

Considering these factors, two privatization approaches – voucher-based mass privatization and liquidation – emerge as the least corruption prone. Management-employees buyouts are conducive to corruption, due to their slow pace and high levels of discretion. Initial public offerings tenders and trade sales fall between the two extremes.

To step back from the narrow comparison of privatization methods and return to the basic question – Does privatization reduce corruption? By breaking old patterns of economic behaviour, and by depoliticising the allocation of resources, it does.

Privatization can also create political pressures to reduce the volume of licence-granting powers held by the state. As new private sector players become better organized, they form political lobbies for lowering the cost of doing business.

An informal survey of the views of about 50 international experts in the field of privatization, while not conclusive, broadly support the hypotheses that over time privatization reduces opportunities for corruption. The process of privatization, while generally having the reputation of being corrupt itself is, nevertheless, still not seen to be as corrupt as other state-controlled transaction. And crucially, those portions of an economy, which have already been privatized, are seen as significantly less corrupt overall than the portions still in the state hands.

Nevertheless, decisions have to be made now. Far less than half of what needs to be privatized in the transition economies has thus far been shifted to the private sector. In deciding how to tackle the second half, policymakers need to pay more attention to the impact of the strategic decisions made today on the environment for corruption tomorrow.

#### **Guide to Case Analysis:**

*To what extent does the argument in this case fit the Tanzanian experience with privatization and what could you recommend as a policy remedy to such a situation?*

## Case No. 7

Theme: Rebalancing Public-Private Sector Relationship and Private Sector Development

### **Problems Frustrating Private Business\***

Starting a business requires courage even in the best of times, courage to take the risk of putting your own money into an idea and courage to take a leap into an unknown future. Throughout the work, millions of entrepreneurs display such courage as they create new businesses. This creative process is the lifeblood of the strong private sectors that drive growth and propel nations forward.

Experience has shown that nations that support their courageous entrepreneurs have grown and prospered over the last 30 years, while nations that have placed barriers to the growth of their small business enterprises have done poorly. Even among countries that have previously discouraged or prohibited such activity in favour of the state as the driving force for economic growth, there is growing recognition of the importance of fostering entrepreneurial activity.

Nikolay Shmelyov, a Russian economist, described the task that governments face in attempting to stimulate economic growth through their private sectors as follows:

*We need to permit companies and organizations to sell freely; to buy and borrow from their reserves so as to create a powerful and vibrant goods market, to invest their enormous but idle resources, to unleash in practice, not just in words, economic initiative in the country. In place of fruitless efforts at central planning of our entire industrial production, we should introduce contracts between supplier and consumer.*

Although he was describing the situation in the former Soviet Union, these tenets apply to all countries seeking to embark upon the dynamic path of private sector enterprise as the most effective means of stimulating economic growth and development.

Governments play a crucial role in helping their entrepreneurs blaze a trail of prosperity by implementing appropriate policies and support programmes. Even countries such as Japan and South Korea, which today boast of as a thriving private

sector, did not achieve success until after the right elements were in place. For countries newly embarking upon the path of market-oriented reforms, the task is the same – the right elements must be in place before sustained growth and progress can be achieved.

What are the right elements? The answer, of course, will not be exactly the same for every country, but there are some basic principles that serve as a framework. Three key points are: a market-oriented policy environment based on sound legal and regulatory structures, entrepreneurial training and development programmes, and government support and assistance programmes, such as access to risk capital for new and small business.

All three of these elements are vital. It is not enough just to provide training and technical assistance or create small, special lending programmes. In so many countries, entrepreneurs must deal with laws and regulations that have become so complex that it is nearly impossible to start a new firm or expand existing operations.

In a now famous example of bureaucratic overkill and its stalling effects on economic activity, participants of a private-public sector workshop listed a number of problems, which haunt the private sector.

One of the leading problems is the socialism hangover among some top leaders within the public sector. The participants charged that most of the leaders in the sector were yet to change their attitudes and behaviour.

Poor leadership among public institutions was another hurdle that erode and hinders prosperity of the private sector in the country. Thus the workshop participants urged the government to enhance leadership and management capacities in the public service. The participants who seemed unhappy with bureaucratic procedures, also appealed to the government to transform the mindset, attitudes and culture of public servants to enable them go on with the liberalization process.

They also noted that most of the public servants were not very much aware of the private sector, and they asked the government to promote public servants awareness and understanding of the private sector's characteristics, potential needs and roles in the country's development. In addition they asked the government to put in place a legal and regulatory framework that facilitates and safeguards the private sector.

\*Adapted from Staff Writer Michael Mbiro in the Daily News, August 14<sup>th</sup>, 1999

Lastly, the participants challenged the government to promote dialogue between the public and private sectors. In one of the papers tabled during the workshop that was held at Sheraton Hotel between July 15 and 16, this year, the presenter gave an example of Peru, of having bureaucratic business registration procedures. He said a research conducted by the Institute for Liberty and Democracy discovered that to register a business required 11 different procedures lasting a total of 289 days. The participants in their deliberations wanted the government to streamline such procedures so as to speed-up the processes and lessen the burdens. It was also hinted in the workshop that countries that have adopted a private sector led approach to economic growth have witnessed encouraging results.

The case of Poland shows how the removal of barriers lets private enterprise flourish. Despite over 40 years of central planning and laws that prevented entrepreneurship, over one million new firms have been established in Poland in just three years, and are earning profits in harsh economic climate.

According to other papers, Latin America abounds with similar success stories. Chile has enjoyed steady economic growth since market-oriented policies were put in place. We are also told that Mexico is currently enjoying an economic renaissance after implementing similar policies. Countries throughout the developing world, including Tanzania, are now following this path.

However, the experts cautioned that in order for a private sector to flourish, good policies and legal and regulatory environment are vital. The experts say that the path to prosperity begins with governments creating an environment in which the private sector can flourish. The enabling environment comes from policies in four basic areas: private prosperity rights, the legal system, efficient government administration and infrastructure.

So on the part of the government, we Tanzanians still have a long way to go in shaping up matters towards this end. Within a few years businessmen and women have established various enterprises after the government abandoned the socialist-economic system or state controlled economy to allow private sector to take root. What is now required is to ensure that these entrepreneurs get proper training for handling and operating their business and, of course, to iron out our policies and legal framework to suit our demands. Starting a business requires courage even in the best of times.

#### **Guide to Case Analysis:**

*Assess the problems facing the private sector in Tanzania and suggest policy measures of dealing with the problems.*

#### **Case No. 8**

Theme: Globalization and Rebalancing Public-Private Sector Relationship

#### **Globalization Should Have a Human Face\***

As the rich world is rushing headlong into greater market integration with the poor states, the 1999 Human Development Report of the United Nations has made a powerful plea in favour of the developing world. The report, launched by the United Nations Development Programme (UNDP) last July in New York, has called for re-writing of the rules of globalization so that it works for the poor nations and not just for profits to be shipped home by the rich countries. The Director of the Human Development Report Office, Sakiko Fukuda-Parr made the following statement:

*As long as globalization is dominated by economic aspects and by the spread of markets, it will put a squeeze on human development. We need a new approach to governance, one that preserves the advantages offered by global markets and competition while allowing for human, community and environmental resources that will ensure globalization works for people and not just profits.*

The co-coordinator of the report, Dr. Richard Jolly, supports the director by saying that as the world is rushing headlong into greater integration, driven mostly by a philosophy of market profitability and economic efficiency, globalization needs a human face. He remarked that "We must bring human development and social protection into equation".

At the high-level conference of Africa, Asian and donor leaders held in Tokyo, Japan in October last year, some of the donor states prescribed globalization as a curative measure for poor countries' economic problems with some reservations. "While I consider globalization to be both inevitable and with full promise, I also believe that governments must be vigilant actors, to regulate its movement and pace and to soften certain destabilizing effects", said the French Cooperation Minister.

According to Africa Recovery, a UN monthly publication of last November, several donor representatives acknowledged the problems Africa faces. They, therefore, called for greater measures to tame the volatility and inequities of international markets, and more efforts to open up industrialized countries markets to African exports. Globalization allows the rich countries to inject capital in the poor states to stimulate development.

\*Adapted from Correspondent Ernest Ambali, in the The Guardian, August 21st 1999

Going by this simple definition, one would be tempted to say globalization has been with us for a long time, that is, if it means the rich injecting capital in the poor countries. But the word "globalization" is a new coinage, contrived from the word "globe". Perhaps globalization is properly seen in the sentence attributed to Dr. Richard Jolly. He says "The world is rushing headlong into greater integration, driven mostly by a philosophy of market profitability and economic efficiency".

The operative phrase here is "rushing headlong into greater integration". This shows the difference between the past and now. It is the rush for profits that frightens the poor countries. This fear is reflected in the statement of the French Cooperation Minister that governments must be vigilant actors, to regulate its globalization movement and pace and soften certain destabilizing effects.

The fear is reinforced by the exploitative colonial behaviour of siphoning Africa's wealth mercilessly. This is the reason why Dr. Jolly adds: "Globalization needs a human face". Colonialists did not have a human face. And Mr. Sakiko Fukuda-Parr said it clearly that "as long as globalization is dominated by economic aspects and by the spread of markets, it will put a squeeze on human development".

If we are to view globalization as colonialism through the backyard, then it should be colonialism with a difference - that it should be regulated so that it operates with "a human face".

But globalization comes after poor Africa's economic programmes have failed to deliver the goods as expected. Bilateral and multilateral aid failed to lift the needy countries out of their economic bog.

Privatization in the context of globalization has resuscitated the near-death TCC and TBL, which failed to generate dividends into the government treasury, which owned 100 per cent of their shares, for years. Just within two years of operation, TBL and TCC under the private investors have generated dividends in the government treasury and raised salaries of their staff although after retiring some of the workers.

These two companies are also giant tax payers, also relied upon by the Value Added Tax (VAT) Department of the Tanzania Revenue Authority (TRA). As long as the government is vigilant to regulate its performance as said by the French Co-

operation Minister in Tokyo, globalization can be tamed to become a good booster of the young economies of Africa and Tanzania.

### Equity, Globalization and Indigenization\*\*

Underlying the campaign started by the Tanzanian Industries and Trade Minister is a sentiment that equity is being trampled upon in economic liberalization and especially the privatization process, to the disfavour of the indigenous community. Tied to it is an oft repeated assertion that this is not what other people do in their countries, that we are being subjected to external pressure to favour their firms.

That many among the foreign aid community in the country are in considerable sympathy with this sentiment, but would do all they can to discourage it since it has the potential of scaring away potential or actual investors, can largely also be understood. Many of them have hardly made up their minds which world they want, the national economy and public-private sector structure of yester years or rampaging globalization.

If one spent time just examining articles from distinctly pro-South opinion, such as the *Third World Network Features*, one would get the impression that all but a fringe of opinion in governments, big banks, IMF and the World Bank agree that globalization is negative.

While there is no doubt that without donors, huge external debts and balance of payments difficulties all these things would not happen, it is also not an accident that they are existing. Just as previous economic policies led to the current requirements of complying with donor economic advice, so it is that explanations for what is being done will reflect the old choices which we never explicitly condemned as an error.

But there is still the question of whether we are victims of global pressure to give foreigners an advantage that they do not accord to us, even if we wished for an opportunity of the kind in their own countries. The chief complaint here has been work permits especially for engineers, though it seems the cases are few and far between, of individuals with roots and local family presence, or related to an investor.

An editorial in the local Financial Times not long ago did point to the fact that the few privatized firms, for example in the textile sub-sector, which were sold to indigenous investors have in the main descended into a nought, if not performing

worse at any rate having nothing to show around. It is difficult to compare with properly privatized firms, with a lot more money for both central and local government.

While Tanzanian across the ruling party and the opposition are (almost) up in arms in favour of indigenisation, they often cite the example of Malaysia and other states of South East Asia, which have a home-grown capitalism. Locals may have been favoured somewhat starting from the 1960s but they were not culturally distant from ethnic Chinas, and it was rather a matter of competition and not really to transplant.

In Tanzania there are at least a few areas where enterprise based on an ethnic group has been able to challenge a number of non-indigenous businesses present, namely in the way in which Chagga business people have largely replaced Indians in Moshi town. With this sole exception, somewhat also true of Arusha Municipality, a home grown challenge to immigrant entrepreneurs if already having roots in the country, lacks.

At any rate, this comparison with Malaysia is awful and of no relevance, since we are talking about an economy where most of its activities, save small scale, hoe-based agriculture, were state-directed. In this respect, the example of how to go about with privatization that Tanzanians should make use of in order to seriously evaluate the rationality of what donors insist must be done here, isn't Malaysia but Russia.

When a disruptive contagion of difficulties in the financial markets of East Asian countries erupted in 1997 all these experts rushed to show how it was globalization that was to blame, cleverly trying to hide the negative loan practices, all tied to sentiments close to 'indigenisation', i.e., cronyism and old-boy affinities. The Malaysians, Thais and others weren't fooled, and in certain cases they did not even seek IMF loans to clear the mess, to return to health.

Put simply, there is no remaining case to show the iniquity, error and moral repugnance of globalization at the moment other than what exists in Africa and Russia, not the success cases of Asia and Latin America. And if one examines the Russian case, it is not difficult to discover that the root cause of its problems was an indigenisation method of privatization, which was in our case tried, catastrophically, with Tanzania Oxygen Limited (TOL).

In the case of Russia people were sold vouchers worth certain shares, without any strategic investor who basically takes control of the enterprise. The end result is that methods of the old management which led to ruin remain, or when local private investors 'buy' major firms, rush for loans as they have no real capital to invest; there are too many of them, policy requires that banks issue loans; many firms default.

Since the Russian of privatization of the economy was chiefly intended to keep out foreign interests wishing to control the economy, there is no exit mechanism where a company in difficulties can easily be handed out to real investors, the way TOL is reversing the original privatization into a new one.

If Russia is proof that an indigenisation model for the selling out of state enterprises is a sheer waste of time, and illusory assurance of indigenous control in which people jump into intensified poverty, there is an aspect to globalization that people forget, or critics ignore. It is the fact that workers in Western countries also oppose the idea of globalization for it ruins employment chances there.

When capital can move across the globe with merely the touch of a computer mouse, capital will diminish its shares in the violence-ridden gold belt in South Africa, or crisis prone Russian mines, or high salaries mining interests in Norway or elsewhere, to take up such opportunities in Tanzania. The millions of dollars in foreign direct investment that flow into the country are 'robbed' from other people by whom? By impersonal, market-based choices requiring a globalized framework to operate efficiently, in which we gain the most.

#### *Guide to Case Analysis:*

*Assess the advantages and disadvantages of globalization in the context of the Tanzanian situation.*

Theme: Private-Community Partnership for Environmental Conservation

**Bonite Bottlers Ltd and Moshi Municipality Community\***

**Background**

Bonite Bottlers Ltd (BBL), a member of the IPP (Industrial Projects Promotion) group of companies, is a privately owned company for bottling soft drinks (Coca-Cola, Fanta, Sprite and Kilimanjaro mineral water). It is located in Moshi Municipality in Kilimanjaro region and was established in 1987.

BBL is an environmentally-friendly company which has so far (1997) spent about Tshs 20 millions for environmental related activities in Kilimanjaro Region. BBL has been dubbed “green company” for its remarkable effort in afforestation in the region. The company has so far planted a total of about 12.5 million trees since 1988 when it started the tree planting campaign. This is about 40% of all trees (31,183,793) planted in Kilimanjaro Region over the period. The trend of tree planting is as follows:

<u>Year</u>	<u>Nr. of Trees (Millions)</u>
1988	0.943
1989	1.8
1990	1.6
1991	1.024
1992	1.02
1993	1.8
1994	2.04
1995	1.1
1996	<u>1.01</u>
Total	<u>12.50</u>

The tree planting campaign is carried out in all the districts of the region.

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\*Aasland, D.G. and E.J. Nkya(1998) 'Good Practices in Environmental Management: Moving from Trade-off to Win-win Situations in Tanzania', Research Report No.15, Agder University College, Norway, and Institute of Development Management, Tanzania .

The BBL’s expressed motivation for such a vast voluntary environmental improvement effort outside the company activities is their “felt obligation” to make a contribution in protecting the environment, particularly after observing massive and fast deforestation in the region. The objective of BBL campaign is to raise awareness of Kilimanjaro people through demonstration and incentives in afforestation, about the importance of conserving the environment through afforestation.

**Partnership Strategy**

BBL employs an incentive-based “competitive participation” strategy to realize their environmental awareness raising and conservation objectives. The strategy entails providing monetary incentives to individuals, local communities, schools, churches and other institutions to encourage them compete in the afforestation programme. Tshs 500 is given by BBL for each tree planted and communities and institutions are invited to compete every year in the number of trees planted. Besides the competition, BBL extended also a Tshs 5 million grant to Moshi Municipal Council to enable the Council mobilize the youth in tree planting.

BBL has enlisted the cooperation of the regional government and, in particular the forestry department and people’s representatives in their environmental initiative. Massive popular response to the campaign led to a shortage of tree seedlings in 1992, and BBL had to introduce a tree nursery competition to encourage people raise their own seedlings instead of depending on the Forestry Department which had failed to supply free seedlings to competitors of the afforestation campaign. BBL have also advised the formation of environment steering committees at regional, district and village levels to mobilize people for afforestation programme. Awareness raising through education is a major strategy used by BBL. At the beginning they used mobile film shows to educate villagers.

Usually BBL begins its annual afforestation competition in October before the short rains by inspecting tree nurseries of those who enter the competition. Before the start of the long rains in March the BBL officials and district forest officers travel to all villages and institutions to remind the villagers that it is time to prepare for tree planting. When the long rains (masika) start the competitors begin planting trees with assistance of experts from the Department of Forestry at district and regional levels. BBL in collaboration with district forest officers and local leaders inspect the trees in July and August and write a report on the inspection which forms the basis for prize awards.

The constraints faced by BBL in their afforestation programme include frequent droughts, shortage of land, cattle grazing on the planted trees, firewood business and forest fires. BBL complained that the fines set by local government by-laws for contravening environmental regulation are too low to be effective deterrents.

Internally BBL is also taking measures to indirectly support afforestation and conserve the environment through 'cleaner production' methods. They have, for example, started using plastic crates instead of wooden ones for the distribution of soft drinks. They also treat waste water from the factory before discharging into Karanga river.

### Analysis

BBL case is interesting because it is one of very few private companies that have taken proactive initiative to improve environmental quality in partnership with local community. Trying to understand the motivation behind this impressive campaign leads to various speculations. BBL is essentially driven by economic interests in all their decisions and actions. It is perhaps easy to infer from this fundamental interest of BBL that their aggressive environmental campaign is driven by their strategic outlook in terms of the longterm financial benefits they can draw from incurring costs now. They intend to remain in the business of soft drinks for a long time and their environmental actions may be viewed as an upfront cultivation of favourable opinion of their customers about the company and its products and also to ensure that the name "BONITE" remains registered in consumers minds.

Speculation in regard to the exemplary actions of BBL are several; they include the view that the Chairman (owner) of IPP group of companies, of which BBL is a member, is an active environmentalist who was also recently appointed the Chairman of NEMC. Indeed his environmental interest accounts in a major way for the behavior of BBL; but whether that is strategic or simply a "passion" for the environment, is not very important here provided the environmental interest is being served. It is also possible that BBL's environmental interest is derived from the fact that their products (soft drinks and portable water) are closely linked with conservation of forests which are the source of water. The threat of drought in Kilimanjaro region may be also a real threat to BBL's longterm economic interests.

It is interesting to note that pursuance of economic interests can lead to a need to improve environmental quality and hence a WIN-WIN situation can be obtained. But this requires that the economic interests understand both their short-term and long-term interests and the implication of environmental deterioration on those interest. This requires a sensitization programme and an effective national environmental policy.

## CASE No. 10

Theme: Public-Private Partnership and Institutional Framework

**Dar-es-Salaam City Commission and Multinet Africa Ltd\***

### Case Background

Multinet Africa Ltd of Dar-es-Salaam was the first or rather a 'pioneer' private company to take part in the privatization of the Solid Waste Management (SWM) in Dar-es-Salaam through PPP (contracting-out) with the City Authorities. The partnership has evolved through three phases starting in 1994 when Multinet was contracted by the then Dar-es-Salaam City Council (DCC-Council) before its dissolution by the Central Government. In the second (1996) and third (1999) phases, Multinet was contracted by the Dar-es-Salaam City Commission (DCC-Commission). The company is governed by six directors and managed by a managing director with three sections: engineering, administration and transport. The structure indicates that the company was incorporated specifically for urban refuse management.

The company, which claims not to be maximizing profits, employs 65 people including two supervisors. They operate 6 refuse collection and disposal vehicles, 5 trailers and 10 push-carts (mikokoteni). Currently they manage to collect on average about 75% of refuse in their contracted area.

In the initial contract Multinet was offered to collect and dispose refuse in ten wards (out of 52) including the city centre (Mchafukoge, Kisutu and Kivukoni) which are categorised as high income areas by the DCC. Besides refuse collection, Multinet was also authorized to collect Refuse Collection Charges (RCC) directly from the garbage generators (service beneficiaries). The first contract was to last five years but was modified after a series of problems were encountered (see below).

Multinet collects about Tshs 2.5 mln per month instead of estimated Tshs 8 mln in revenue which they claim to be far below their operational costs. Besides the trading premises, they serve about 4,000 households at Tshs 2,000 per households. On why they should operate at a loss, the respondent said that "the owners of the company are interested not only in profit but also honour and prestige" (translated from Swahili).

\*Nkya, E.J. (2002) 'Public-Private Sector Partnership and Institutional Framework at local Level: The Case of Solid Waste Management in Dar es Salaam, Tanzania, Research Report. Local Government Centre, IDM Mzumbwe

The main problems they encounter in executing the contract are:

- Reluctance of beneficiaries to pay the RCCs on the claim that they have already been paid by the DCC out of their “development levy” and “city service levy”. Most beneficiaries do pay, however, because as the respondent put it, “they are educated and well-off”. Government offices do not, however, honour their obligation to pay RCCs.
- The beneficiaries are not aware of the by-Laws which require them to pay RCCs.
- Refuse collectors (workers) are harassed and sometimes assaulted by some beneficiaries because they claim the workers are doing ‘double’ collection of RCCs, the other being payment through city taxes.
- Non-payment of RCCs which necessitate prosecution of defaulters in which Multinet is a witness and DCC is the plaintiff. The process of litigation takes a lot of time. From December 1997 to August 1998 they prosecuted 82 defaulters out of whom 25 never paid.

#### Case Analysis: Public-Private Partnership and Institutional Framework

Major aspects related to ‘institutional arrangements’ (rules of the game) arise from contractual arrangements of the Partnership and rules and regulations, including enforcement by the DCC. First, in regard to the Multinet, the first partnership arrangement was based on a contract drawn and signed in phase one (1994) and modified in phase two (1996) when other four operators were contracted to provide SWM services in other wards of the city. In the current phase (1999) with expanded participation of NGOs and CBOs, operators are working on the basis of a one page ‘offer letter’ which is not a formal contract. Formal contracts are being worked out, however.

In regard to the first contract between Multinet and DCC, the following contractual aspects presented constraints that tended to raise transaction costs but which, over time, have been or are being addressed in the current (1999) draft contract and the 1993 Contract :

- In the 1993 Contract the method of payment was restrictive. The contractor was required to collect RCCs and deposit it in a ‘joint account’. Under the ‘conditions of contract’ clause 8 the contract provided that *‘during the commissioning period any refuse collection charge collected shall be paid into a joint bank account to be opened in the joint names of the contractor and the city council and may be released under the joint signatures of the contractor and the Authorized Supervising Officer to purchase, hire or lease of Premises and Plant required for the contract’*. This points more to a ‘chase’ for money rather than a pursuit for ‘value for money’.

- Excessively detailed contract indicating lack of ‘mutual trust’ and suspicion. Examples are the conditions of the 1993 Contract under clauses 5(d), 13(d), 7, and 9 on ‘monitoring and control’ and mandatory ‘monthly statements’. These clauses tend to be ‘paternalistic’ and control oriented. They have a tendency to raise transaction costs and reinforce mutual distrust.
- The restrictive condition on ‘assignment’ (clause 11) that restricts sub-contracting and conditions on vehicle operations (clause 14) and on staff (clause 15(b)) are again paternalistic, control oriented and indicative of mistrust (1993 Contract).
- In the draft contract of 1999 (D13) the contract duration is shortened from five years to one year (clause 5 of the ‘an agreement for refuse collection’ p1). Although renewable, this may induce contractors to adopt a short-term view of service provision to the detriment of longterm investment and pursue short-term profit maximization. This concern was also expressed by respondents in the DCC.
- A provision of the possibility of the Authority doing the work of contractor in case of default may lead to paying beneficiaries questioning the rationale of the DCC to serve some beneficiaries free of charge while others have to pay direct to the operators (clause 13 of terms and conditions of the draft contract).
- Obligations of the DCC do not come out clearly and categorically in the contractual arrangements. In particular, the role of DCC to inform and raise awareness of the beneficiary public is not at all included as an obligation of the DCC. Being a ‘public good’, awareness, if done separately by individual operators, may induce ‘free riding’ problem and may end up not being carried out altogether.
- Obligations of the beneficiaries which are spelt out in the 1993 City By-Laws (document D3) (e.g. *‘to provide receptacle for domestic refuse’* in section 4) do not appear in the contract. Also beneficiaries are not aware (informed by DCC) of this provision aimed at facilitating the work of garbage collectors.
- The delegation of RCCs collection responsibility to the operators is a major constraint expressed by Multinet and others. Operationally, it is difficult to convince beneficiaries that are served by private operators to pay RCCs while others are still served free of charge by the DCC. That is, the latter group are viewed as being served by their taxes while the former have ‘extra’ tax burden (the RCCs).
- With the new wave of privatization (1998/99), Multinet as all the other operators, were issued with ‘offer letters’ in lieu of a contract (document D15). This was, however, considered a ‘bridging’ measure while new and better contract formats were being prepared by the DCC. Those “offer letters” do not contain all the necessary contractual clauses and thus a source of conflicts between the partners.

## CASE No. 11

Theme: Partnership between Public Sector and Non-Governmental Organizations

### Dar-es-Salaam City Commission and Pendelea Environmental Women Group\*

#### Case Background

Dar-es-Salaam City Commission Contracted Pendelea Environmental Women Group (PEWGRO) which started activities in 1997 as a voluntary membership NGO concerned with city environmental issues and activities. PEWGRO, who comprise 24 members and 25 employees, were also involved in micro enterprises. About 200 casual labourers are also involved in their activities.

When the DCC announced the refuse collection opportunities the group found itself in a good position to participate because of their involvement in city environmental issues. They sought a business licence through a long and tedious process which took them about a year to complete. They started refuse collection activities in January 1999 in Tandika area (a low income area) allocated to them by the DCC-Commission. They usually hire vehicles from DCC-Commission and pay Tshs 20,000 for every three hours of operation. They also hire from private vehicle owners.

PEWGRO's RCCs are lower than those given by DCC (except for restaurants) because they tend to follow the market forces and ability of their customers which are a low income group. Their monthly rates compared with DCC set rates are as follows:

	<u>PEWGRO</u>	<u>DCC</u>
Kaya (household)	Tshs 300	(500)
Shops	Tshs 3,000	(5,000)
Guest Houses	Tshs 5,000	(10,000)
Groceries	Tshs 5,000	(10,000)
Restaurants	Tshs 10,000	(10,000)

\* Nkya, E.J. (2002) 'Public-Private Sector Partnership and Institutional Framework at Local Level: The Case of Solid Waste Management in Dar es Salaam, Tanzania', Research Report, Local Government Centre, IDM Mzumbe

PEWGRO's revenue collection is not encouraging if compared with their own estimated revenues, as shown below:

Year 1999	Estimated RCCs Revenue	Actual RCCs Revenue
	(Tshs)	(Tshs)
February	2.6 mln	292,000
March	2.6 mln	370,572
April	2.6 mln	475,000
May	2.6 mln	382,000
June	2.6 mln	222,000

#### 1.2 Case Analysis: Public-Private Partnership and Institutional Arrangements

Besides the above poor performance of revenue collection, problems faced by PEWGRO in their operations (related to 'institutional arrangements') are:

- Refusal by some clients, particularly shop owners, to pay RCCs on the grounds that they have already paid licence fees. Beneficiaries base their refusal on the fact that other areas of the city do not pay RCCs and yet get DCC refuse collection services. This is the problem of non-uniform application of rules and regulations.
- High costs (particularly in terms of time) of prosecuting defaulters and hence high transaction costs. They cited an example that, it takes more than three months to prosecute a defaulter of only Tshs 2,000.
- They have yet to get a formal contract. They operate only on the basis of an 'offer letter'. They were told by the DCC to work for some time under the present arrangement as a sort of 'test period' after which they will be considered for a formal contract.

The cost coming the DCC's refuse grinder and separation of soft and hard refuse is TShs. 120,000 per day.

Theme: Public-Private Partnership and Non-Governmental Organizations

**Dar-es-Salaam City Commission and Tanzania Environmental  
Cleanliness Association\***

**Case Background**

The Tanzania Environmental Cleanliness Association (TECA) started refuse collection operations in February 1998 as a participant in the second phase of privatization. A contract document was not made available by the respondent but they were contracted on the same terms and conditions as KEL and MULTNET. Unlike the previous two, however, TECA is an NGO. They employ 49 permanent workers and other 10 are on a three-month employment contract. They own 3 vehicles for operations and 12 push carts. The allocated areas of collection are Upanga East and West which are categorised by DCC as high income areas.

They are contracted by DCC to provide the following services under conditions and terms similar to those of the other contractors: cleaning of streets and drainage, refuse collection, trimming grass and trees, and removal of carcasses. They are also required to dispose refuse at the dump sites. Daily collection and disposal capacity is 3 trips and they collect, on average, about Tshs 5.5 mln per month as against expectation of Tshs 7.5 mln. - their rated capacity. They are flexible in the collection of RCCs in the sense that some customers are invoiced monthly and others pay on the spot on collection of garbage. They estimate that for about 75% of collections, however, two visits or more have to be made before payment is effected which raises transaction costs. A special form for RCCs collection is designed by the operator to include signatures of both the collector and the customer for invoicing purposes which could also be used later in court in case of default.

They also admitted that their area (Upanga) is systematically built with a considerable number of enlightened residents. As remarked by the respondent "some customers have built a trust on us such that they even pay the RCCs for a whole year in advance. Even when sometimes we delay collection for unavoidable reasons, they accept our apologies without fuss". They insisted that what perhaps matters in this business, in which DCC (Council) had put a bad performance record, is to 'invest' in creating and nurturing public/customer 'trust' and 'credibility' through dialogue and effective service. "What matters is not only making money and collecting refuse. Beneficiaries want also to be heard".

\* Nkya, E.J. (2002) 'Public-Private Sector Partnership and Institutional Framework at Local Level: The Case of Solid Waste Management in Dar es Salaam, Tanzania', Research Report. Local Government Centre, IDM Mzambe

The main problems faced by TECA are:

- Poor condition of the dumpsite at Vingunguti particularly during the rainy season when vehicles take up to four hours to make a return trip (of 10 km).
- Use of 'alternative' unauthorized refuse collectors and use of means such as push-carts (mikokoteni). Such means infringe on the 'exclusive rights' of the operator to operate in the area. Moreover, refuse is disposed at unauthorized locations such as in Jangwani Valley.
- Complaints by some beneficiaries about yet another levy (RCCs) on top of many other levies and taxes charged by the DCC-Commission.

**Case Analysis: Public-Private Partnership and Institutional Arrangements**

The main aspect related to "institutional arrangements" (rules of the game) in this case is on building *mutual trust* and *credibility* and hence development of *informal norms*. After facing or learning about practical constraints entailed in SWM in Dar-es-Salaam, TECA entered into partnership with some very innovative ideas in order to go around the problems faced by other operators. First they engaged into a 'dialogue' with the beneficiaries about their approach to garbage collection which entailed provision of service before specifying or enforcing the DCC rates. After the beneficiaries were served for a few days they were requested to assess the service and indicate how much they were ready to pay. This market driven and signalled service provision approach takes into account preferences, ability and satisfaction of customers to determine the level of RCCs. At the beginning, and for some customers, TECA did not charge the given DCC service charges. As put by a respondent and translated from Swahili, "We do tell them that we shall first collect garbage and if you are satisfied you pay us". After this they have no problem in paying the contractor. They also added that their RCCs depend on the ability of the customer. They argue that it is better to increase total revenue with a large number of customers rather than maximize profit with few customers.

This is a case where the development of *norms, trust and credibility* as informal constraints is crucial in any undertaking involving people. According to North, 1990) *informal constraints* include unwritten constraints that have evolved from formal rules in the context of repeated interactions (exchange) among players and socially sanctioned norms of behavior. If they are entrenched and sustainable in a community they become *social capital* that could be used for increasing output in society. TECA insisted that DCC should raise city residents' awareness through mass media (TV and radio), presumably as one way of building this social capital.

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The process of economic development and paradigm shifts evident in the 1980s and still unfolding, led to economic and institutional reforms that necessitated rethinking the balance and relationship between the public and private sectors in both developing and developed countries. Reforms in the public, financial and fiscal sectors and macroeconomic stabilization have necessitated changes in economic development policies that recognize the importance of private sector in economic development. *Public-Private Sector Relationship in Economic Development* analyses the changing relationship between public and private sectors in favour of the latter, as a strategic policy change for faster economic development and poverty alleviation. The analysis is based on a review of relevant theories, public-private sector rebalancing experience in Tanzania, and illustrative case studies from author's research projects in Tanzania. Development policies are viewed as important instruments for changing the balance between the public and private sectors.

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