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Notes on the Public Sector Enterprises in the Sudan; Privatization Experience

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1. INTRODUCTION

Generally speaking the topic which this Workshop is handling could be considered from two angles :

a. administrative reforms of the public sector enterprises,,
b. privatization of the public sector enterprises.

1.1 Administrative Reforms

It is not our intention in this paper to spend much time on the experience of the Sudan in reforming its public sector enterprises. We take this position because :

(i) public sector administrative reforms have always been under- taken within the context of reforming the Sudan Civil Service [this aspect is covered by my colleague Dr. Kamal M. Zain in his paper to this Workshop],

(ii) the prevailing policy of the government toward the public sector enterprises is no longer administrative reforms but privatization.

Notwithstanding what we said above it should be pointed out that serious (albeit incomprehensive) administrative reforms of the civil service and the public sector have been made by the different governments since the early 1970s. It should also be pointed out that despite the wide differences in political ideologies that prevailed since the 1970s, the philosophy and mechanisms that shapped the administrative reforms have remained almost the same; namely the over-emphasis of the mechanical aspects of administrative reforms (i.e., the emphasis on the legal and the structural aspects of reforms at the expense of the behavioural aspects).

1.2 Privatization

At the outset we should point out that although privatization as a philosophy has been talked about in the government and academic

circles of the Sudan since the 1970s, it was only when the currrent government adopted the structural adjustment philosophy (and concomitantly the structural adjustment programs, SAPs) that privatization became a reality. Needless-to-say, since our privatization experience is recent and short (since 1990), some basic data is not available and the lessons to be learnt and exchanged are still to be written. Basic among the data which is still to collected is the impact of privation on :

(i) the size of the workforce of the public sector enterprises,
(ii) the productivity of the workforce of the public sector enterprises.

2. SOME THEORETICAL NOTES

2.1 Definition of Public Enterprise

It should not come as a surprise if we say that there is no universal definition for the concept "public enterprise." How the concept is defined differs substantially between countries particularly those of different socio-economic systems. In this respect Leonad D. White stated that :

> "analysis of government corporations reveals no single or uniform type of corporate structure. They vary in the method of incorporation, in their relation to the central administrative structure, in the degree of operating independence, in the source of their capital funds and in their organization."[1]

It could easily be noticed that the shape, type, field of activity and policy/philosophy of the "public enterprise" are related to the environmental factors of the country concerned (namely, the country's ideology, stage of development, the legal and political framework).

2.2 Types of Public Enterprises

Public ownership of the means of production and distribution has existed since the emergence of the "state" in early civilizations. In mixed-economy countries exist four basic legal forms of public enterprise. Each of these forms has its (own) features which distinguish it from the others. These forms are :[2]

(i) Departmental Enterprises :

They are the traditional type of public enterprises for which the minister is fully responsible. It has been used for railways, communications, ports, etc. Its main features are stated in N.S. Carey, when he defined it as :

> "A normal government department operates with money appropriated under more or less detailed headings (either by item of expenditure or by function) and issued from a single government fund. Its staff are civil servants, subjects to fairly stringent staffing and personnel rules, its finances are subject to equally stringent financial rules."[3]

A United Nations Report displays more detailed characteristics for a "departmental enterprise" in its pure form as follows :-

> "The advantages of departmental enterprise are that it lacks ambiquity about the degree of public accountability, in addition to its clear relationship with other parts of the government structure. Its disadvantages are that : it allows the government to exercise its full power and in this exercise it hinders and minimizes the initiative and flexibility of the governmental department as well as the excessive practice of the red-tape bureaucracy, which usually prevails in governmental institutions."[4]

(ii) The State Company :

It is the company which is established under the general law of the state. It may be effectively independent with little government intervention, or it may be tied-up by its article of association or by

contracts with the government. It is defined by A.H. Hanson as denoting :

> "An enterprise established under the ordinary company law of the state concerned, in which the government has a controlling interest through its ownership of all or some of the shares."[5]

(iii) Joint-Venture Enterprise :

Usually it takes the form of a mixed enterprise, with joint private and public ownership. It is defined by Robert Lacy as :

> "The enterprise in which finance and management are shared between the government and the private firms, often foreign ones, for instance Kenya Government is often represented in such enterprises by a parastatal organization, such an organization may hold shares in the company operating a project, may extent a loan to it and may have representation on its Board of Directors."[6]

(iv) The Public Corporation :

W. Friedman defined it as :

> "An institution operating a service of an economic or social character, on behalf of the government, but as an independent legal entity, largely autonomous in its management, though responsible to the public via government and parliament and subject to some direction by the government, equipped on the other hand with independent and separate funds of its own and the legal and commercial attributes of a commercial enterprise."[7]

2.3 Reasons for Privatization

As in most places, both "pull" and "push" factors have facilitated moves towards privatization in Africa. The primary "pull" factors have

been significant budgetary drains and severe foreign exchange scarcity in conjunction with fiscal and debt crises, general economic decline and decay, and the demonstrated economic inefficiencies of state-owned enterprises. These "pull" facors played a major role in economic reform efforts in general and in privatization in particular.

The chief "push" factors are substantially external pressures from the International Monetary Fund (IMF), the World Bank, and the donor countries in a context of heavy direct and implied conditionality and a desperate need for external resources on the part of African governments. Donor countries have believed that providing new money without major macro-economic policy and structural changes would be pouring money down an enormous African sinkhole. They have wanted debt service maintained, African markets and productive capacity revived and their own continued economic access to these markets assured. For certain donor countries, an ideological impetus designate non-market, non-western economic model, patterns, and linkages and to praise and to foster Western capitalism has also played an important role. For Africa more than other regions, the "push" factors have been very important, probably predominantly so, directly and indirectly via various types of conditionality by a wide variety of external actors privatization has been placed on the African agenda in a forceful way.

The role of the World Bank and the IMF as "push" factors that provided the external stimulus towards privatization in developing countries can be summarized as follows :[9]

From the outset, the World Bank stressed the advantages of the market mechanism. As a report of one of its first economic missions to developing countries put it : "To date, none of man's efforts to repeal the law of supply and demand have been successful." In addition, the Bank embraced a doctrine that regarded private enterprises as the engine of growth and development. The Bank's main articles of agreement stipulated that one of its principal objectives was to promote private investment, both foreign and domestic. The articles also inclined the Bank from engaging in any lending operation if commercial finance was available "on reasonable terms." The Bank did concede a place for government involvement in economic development, regarded

it as little more than instrumental [to provide an institutional framework that would enable private entities to operate effectivaly]. Besides creating a favourable environment for investment via such measures as appropriate tariff levels and incentive tax policies, the government's assigned role entailed investment in economic infrastructure [power complexes, transport network, port installation and telecommunication facilities]. The Bank found its own niche in the financing of the foreign exchange cost for such "hard hat" capital intensive investments. The justification for providing long-term loans to governments for infrastructure projects was identical with the justification for the existence of the Bank itself : To compensate for market failure. Once the need for such government involvement was conceded, there remained but a short step to the advocacy of development planning. In settings characterized by glaring resource scarcities, as well as wide price distortions, the visible hand was needed to guide investment decisions in order to insure a more rational allocation of capital. Ultimately, the call for national economic development programmes, and the concomitant insistance on the determination of priorities in project design and selection was anchored in presumptions about the need to compensate for the market mechanism. The Bank position on the role of state in industry was neither absolute nor consistent, however. Even in its early survey missions, while invariably calling for greater scope for the private sector, it did not draw a hard and fast rule across countries on government-ownership and private ownership of manufacturing. Nor did they advocate divestment of state-owned enterprises. Remedies such as privatization, they warned "posed serious problem which needed careful study and preparation." Instead, they emphasized the need for reorganization and reforms in management to insure a greater measure of efficiency. The Bank found itself faced with an awkward situation, one that it has yet to overcome. One one hand, for all its exhortations and protestations, it happened to be doing too little for the private sector, on the other hand, the limitations imposed on its lending policies denied it the opportunity to exercise much influence in many areas of activity that were of critical concern to both itself and its borrowers. Two other factors compounded the anomaly : first, the Bank was bound by its articles of agreement to secure a government guarantee for all its loans, regardless of whether they went to public or private parties. Yet, the

governments did not readily offer such guarantees to private companies. Nor did those companies readily seek them.

The creation of the International Finance Corporation (IFC) in 1956 in contrast to both the (IBRD) and the Bank's soft loan affiliate, the International Development Association (IDA), was authorized to make equity investment and to extend loans without government guarantees. Its presence, however, did little to reverse the concentration of the Bank group lending in the public sector.

In the early 1960s, the Bank began to relax its structures on lending to public sector industrial projects. In due course, it found itself directly financing state-owned industries.

Lending policies have shown increasing indifference to the choice of borrower as it concerns the public-private decide. All along, the Bank's cardinal concern has been not who owns an enterprise, but how that enterprise is run.

The IMF also has devoted substantial attention to assessing the impact of state-owned enterprises. Both the Bank and the Fund have been at pains to stress the large and growing claims that state-owned enterprises make on national treasuries. In recent years the Bank and the Fund have issued a stream of reports that assign much of the blame for the backwardness and instability in developing economies to excessive government intervention. They have delivered particularly critical assessment of the state owned enterprises typically portraying them as "privileged dead beats" whose time has gone - "overextended entities" that have grown accustomed to making unsustainable claims on the state budget, that stifle the growth of private initiative, and that are incapable of meeting their economic goals, let alone their social ones.

Running through such report is a common theme - the state needs to place greater reliance on the market as the essential mechanism of allocation and distribution and, in the process must make more room for the private sector.

2.4 The Forms of Privatization :[10]

Privatization in Africa is a highly political process. Politics usually determines what is to be privatized, the form of privatization, the value of enterprises, who may participate and so on.

Generally speaking, there are six forms of privatization :

i) Public offer of shares : To offer the state-owned shares in the enterprise to the public at large, [i.e. replacing the government ownership by public ownership].

ii) Private placement of shares : The state-owned shares in the enterprise to be transferred to a private individual(s).

iii) Management buy out : For example by "management contracts" with a private firm a public enterprise can be managed.

iv) Debt equity Swap : To transfer the ownership of the public enterprise to the private sector in settlement of their debt.

v) Liquidation of the company via the break up and/or sale of its assets.

vi) Deferred public offer, such as offering the shares of the public enterprise to its employees, etc.

In addition to the above, under-implementation public projects can be (in order to be financed by private participation) privatized by the following methods :-[11]

i) Build-own-operate : This method applies when the project is new and the government wants to build its infrastructure which is not available at hand, so the government can rely on

a private enterprise to implement the project, and so manage it as an owner, and continue to own, and render the prescribed service in agreement with the government.

In this way, the government, then, will enhance the role of the private sector, which retains the ownership of the implemented project and hence keep the size of the state-owned enterprises limited.

ii) Built-Operate-Transfer (BOT) : By this method the financing private enterprise company then bears the burden of implementing the project and then carry out its operation to earn sufficient return, as a consideration for the cost of implementation before transferring its ownership to the government within a predetermined period. In this case privatization is a transitional process. The implemented project will not remain in the ownership of the private firm forever, but transferred to the state and then becomes a part of the state-owned enterprises.

iii) There are many other methods drived from these two methods, like "buy, build, operate" which is useful when the project is completely implemented by the government. And the government wants to expand its activities by building an additional extension to it. So the assets of the project can be sold to a private firm with the condition of carrying out this extension to increase the capacity of the project and guarantee its operation.

Also "rent, build, operate", which is very similar to the above one except for the avoidance of complete selling.

These methods constitute a modern way to overcome the lack of public capital for investments.

2.5 Objectives and Merits of Privatization

As an economic policy, privatization is based on the efficiency of the market mechanism and hence the view that private ownership and management is more efficient in terms of resources allocation and cost than public ownership.

Besides, both industrial and developing countries that carry a heavy public debt burden may consider privatization a relatively quick way to reduce their public debt, that is to say, by divesting loss-making public enterprises. Again, the sale proceeds of a privatization programme may be used to reduce government debt.

Hence the objective of privatization may be summarized as :-

a) To achieve optimum allocation of resources and enhance economic efficiency.

b) To enhance the role of private sector in the economy, to speed up the process of recovery and sustained growth.

c) To reduce public debt.

2.6 Counter Views

In an interview with Professor Mohamed Hashim Awad, [Faculty of Economic and Social Studies, University of Khartoum], he stated that public sector enterprises are generally more efficient than the private sector enterprises in Sudan despite what is said, why ?

Because the public sector is pioneer in most areas like irrigated agriculture, mechanized agriculture, industry, mining, and modern services. The private sector is always a follower. The public sector made a lot of losses but usually not of being inefficient but because of political interference especially in prices of public goods which were deliberately kept low as a subsidy to the poor. Sometimes, production units (like the sugar factories) were made to sell at factory cost and large profits were appropriated by the Sugar Marketing Corporation. Sometimes, the reason was failure to give incentives like the one given to the private sector (units and employees) which kept morale low in the

public sector. it should be remembered that the private sector benefits from very generous tax concessions and protective tariff granted to it under various investment laws; the public sector receives no such concession or protection.

One must also remember that most of the leaders of the private sector and the bulk of its employees came from the public sector. The private sector has been able to attract these people by offering them high salaries and rewards.

The private sector is often benefiting from tax evasion which the public cannot practice.

The wages in the public sector are always very low compared to those of private sector; this naturally kills any incentive among government employees to raise productivity.

Lastly, in recent years when privatization was widely advocated and practiced the private sector hardly made new investment or raised productivity. The most remarkable increases in production were in government-owned agricultural schemes and sugar factories.

He concluded by saying :

"I believe that the notions that the public sectors are inefficient and that the private sectors are efficient and productive are simply myth propagated by the IMF and private business."

2.3 Necessary Conditions for Privatization

The participants in the Seminar on Various Approaches to Privatization in Africa, identified general conditions that are necessary for a programme of privatization. Those conditions are :-

a) There must be political supprt at the highest level of government for the programme. Where necessary, appropriate legislation should provide the legal basis for the programme.

b) Every effort must be made to explain the programme of privatization to the general public. It was noted that if transparency in the transfer of assets is to be maintained, the publicity aspect of the programme should not be underestimated.

c) Consultation with employees of the enterprises to be divested is also necessary for transparency and probity where feasible employees should be encouraged to assit the process of designing the modality and strategy of divesment and its implementation. As privatization usually results in redundancies, efforts must be made to retain redundant staff and workers and/or provide satisfactory compensation packages. Efforts should also be made to mitigate the undesirable social consequences of privatization.

d) While private sales and private placement may be necessary under certain circumstances, transparency requires that efforts must be made to facilitate public sales. In view of the skewed distribution of savings in most African countries, equity also demands that as a wide spectrum as possible of the general public must be given an opportunity to become shareholders of divested assets. To this end the lending institution must be made prepared and encouraged to provide loan advances to investors including the small-scale investor. The case of Nigeria where employers were encouraged to provide their employees with salary advances to purchase shares was noted and commended.

e) Successful privatization requires a financial infrastructure of capital markets, banks, brokerage houses, accountants, lawyers and stock exchange (to faciliate secondary trading of stock or as a mechanism for raising new capital). While this infrastructure is underdeveloped in most African countries, its development must be given priority as part of an overall strategy of private sector development.

f) Finally, as a private sector assumes its rightfull role as the main vehicle of entrepreneurship, initiative and innovation in African economies, governments must strengthen their policy-making and regulatory capacities to insure that fair practices are maintained and that employees and consumers are adequately protected.[12]

3. Privatization in the Sudan [13]

3.1 The consecutive socio-economic development plans have given birth to the following public corporations, departmental enterprises, and state companies :-

- 73 public enterprises under the supervision of the Ministry of Finance and Economics [with special reference to their budgets].

- 17 public enterprises in the agricultural sector.

- 8 public enterprises in the transport and communications sectors and the tourism and hotels sector.

- 15 public enterprises in the energy sector and the diversified sector.

- 71 state companies under the supervision of the Investment Department (one of the departments of the Public Enterprises Administration).

3.2 The performance of all enterprises has been characterized by failure to achieve their objectives, failure to realize profits, and in some cases, failure to rely on their own resources. Consequently, all of these enterprises became a burden on the treasury. This dismal performance could be attributed to the following reasons :

(i) the weakness of the administrations of these enterprises; the decline of their production and productivity; the distortion of the costing and pricing mechanisms; the diversity of the

organizations that ovresee these enterprises; the excessive workforce and payroll; the weakness of the executive ability; the weakness of the central supervision; the erosion of the invested capital; the weakness of the direct net return from profits, the surplus of the current budget as well as returns on invested capitals,

(ii) the weakness of the administrative, supervisory, and executive leadership; the shortage of the skilled cadres; the absence of the necessary training programs; the absence of standards for the proper control, follow-up, and accountability; and the forfeiture of responsibilities to achieve specified production and financial objectives,

(iii) lack of clarity of objectives, plans, and programs; the weak preparation of budgets; the absence of proper financial and economic standards; the delays in closing the current accounts as well as the periodic audits; the shortage of self-financing; and the lack of sources of foreign financing,

(iv) the obsolescence and erosion of the means of production; the shortage of spareparts; the irregularity of periodic maintenance; the instability of the renewal and replacement programs; and the instability of the economic and financial policies.

3.3 The Call for Privatization

3.3.1 In the light of the poor status of public enterprises, the National Salvation Revolution (the present government) presented the issue of "privatization" to the Economic Salvation Conference (`1989). The Conference recommended that "privatization" be adopted as a means of alleviating the shortcomings of the economy. This recommendation was taken as one of the basic directives of the Three-Year Economic Recovery Program (1990-93) as well as the Comprehensive National Strategy (1990-2000).

3.3.2 The government adopted the philosophy and policy of privatization as a means of restructuring the economy and the public sector enterprises. Restructuring the public enterprises is meant to bridge the gap between their low (actual) performance and the (desired) performance which would enablethem to compete (at the international level).

3.3.3 The privatization program which has been adopted aims at :-

(i) decreasing the role of the government in the economic/commercial activities,

(ii) limiting the financial burden on the treasury that results from the subsidy and capital provided to these enterprises,

(iii) promoting the competive position and improve the performance and efficiency of these enterprises,

(iv) expanding the base of ownership of invested assets,

(v) encouraging the establishment and development of stock/financial markets,

(vi) decreasing the interference of the government in the operations of these enterprises,

(vii) encouraging the participation of local and foreign investments in these enterprises.

3.4 <u>How Are Public Enterprises Valued</u>?

In deciding what method(s) to use for valuing the public enterprises which would be disposed of the technical committee entrusted with the disposal programe adopted <u>two</u> <u>methods</u> (the committee maintains that its choice was guided by the current circumstances of the country as well as the experiences of other countries): -

(i) the financial vaue of the future cash inflow of the enterprise as an on-going concern on the assumption that the enterprise will remain "operating"; the only difference being the transfer of its ownership,

(ii) liquidation of the enterprise (i.e., selling of its assets "in total" or "in parts") through "public auction" or "trade sale". This is done after determining the minimum value of the enterprise on the assumption that the enterprise will not remain an on-going concern.

3.5 The Steps Taken to Implement the Privatization Program

The first step in this program was the formation of a Technical Committee (in June 1990) entrusted with a multiplicity of duties : designing a detailed, action-oriented program for privatization and divestment; recommening ways and means to settle the claims and rights of the various interested parties; etc.

The second step witnessed the formation of a Ministrial Committee (in November 1991) to consider the recommendations of the above-mentioned technical committee.

The third step : the ministrial committee jointly with the technical committee passed the basic guidelines/principles of what to do with the public enterprises. These guidelines are :

(i) financial performance
(ii) strategic importance
(iii) gradual transfer

On the basis of these guidelines the public enterprises were divided into three categories to be disposed of during three periods of time; namely :

(i) During the first period (the financial year 1992/93) fifty enterprises [7 agricultural, 19 industrial, 3 in the

transport and communications sector, 7 in the energy and mining sector, 7 in the commercial sector and 7 in the mixed sector].

(ii) During the second period (which will last for 2-3 years) thirty five enterprises [5 agricultural enterprises, 16 industrial enterprises, 6 enterprises in the transport and communications sector, and 8 in the banking sector].

(iii) During the third period (which will last for more than three years) 47 enterprises [4 agricultural enterprises, 6 industrial enterprises, 4 enterprises in the transport and communications sector, 4 enterprises in the energy and mining sector, 4 enterprises in the diversified sector, and 25 in the mixed sector].

It should be noted that in this step very major decisions have been made :-

(i) the number and type of public enterprises to be disposed of,

(ii) the time needed to dispose to these enterprises,

(iii) the modality of disposal/privatization.

3.6 Modality

Five modals have been adopted :

(i) "trade sale" (i.e., the full transfer of government ownership to the buyer),

(ii)"public offer" (the enterprise remains in the government's hand; however, foreign and local investors are asked to join in the ownership),

(iii) "lease" (the goverment wants to keep the ownership of the enterprise, however, for some unspecified reasons, wants to lease it),

(iv) liquidation/divesture (this is done through cancelling the act of incorporation),

(v) transfer (the transfer of the enterprise as a whole or any part(s) of it to the state/regional government(s). This happens where an enterprise is located in different parts of the country).

3.7 The Legal Framework

The Disposal of the Public Sector Enterprises Act was promulgated on the 6th of August 1990 :

- Article 4 Section (1) stated that a High Committee for Disposing of Public Sector Enterprises is to be constituted.
- Article 3 Section (2) determined the membership of the High Committee.
- Article 4 stated the functions/duties and authorities of the High Committee.
- Article 5 stated that a Technical Committee be constituted; determined its membership, and its subordination to the High Committee.
- Article 6 determined the functions/duties and authorities of the Technical Committee.
- Article 7 determined the functions/duties of the chairman of the Public Administration for Investment.
- Article 9 stated that courts do not have jurisdictions over the actions/decisions undertaken within the context of this Act.

Footnotes :

[1] Leonard D. White, Introduction the Study of Public Administration, (MaCmillan, New York, 1959), p. 130.

[2] Mohammed Hassan," Public Corporations in the Sudan and Their Role in Development" [Unpublished M.P.A. thesis], (University of Khartoum, 1991), p. 14.

[3] Ibid., p. 14.

[4] Ibid., p. 19.

[5] Ibid., p. 20

[6] Ibid., p. 14

[7] Ibid., p. 16

[8] This Section draws heavily from :

(i) Vernon, Raymond, The Promise of Privatization [the Council of Foreign Relations, USA, 1988], p. 180.

(ii) Nuha M. H. Shallali, "The Comparison Between The Private and Public Enterprises in Sudan" [Unpublished Public Administration Diploma] (University of Khartoum, 1994), pp. 16-21.

[9] Vernon, R., op.cit., p. 256.

[10] Ibid., p. 187 and [11] Bodour Abu Affan, "Privatization in the Sudan : Past and Present", a paper presented to the Seminar on the Various Approaches to Privatization in Africa (Khartoum, 24-28 October, 1992).

[12] Vernon, R. op.cit., p. 187.

[13] This Section relies heavily on a paper presented by the Technical Committee for the Privatization of the Public Sector Enterprises to the Seminar on the Role of the Private Sector in the Development of Investment in the Sudan. (Khartoum, 10-11 January, 1994).