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The Privatization Conundrum: A look at the Historical Perspective of Privatization through to its Current Outlook in Kenya

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Abstract

This paper explores the history of privatization in Kenya, examining key events, policies and their impacts on the economy. Through a historical lens, it aims to provide insight into the evolution of privatization in Kenya and the implications on the nation's economic trajectory. This perspective is particularly important as the country has just passed new legislation to implement an ambitious plan to privatize thirty-five (35) state corporations.

Introduction

Post-independence, the government through Sessional Paper No. 10 of 1965 established public entities and parastatals to: accelerate economic and social development; redress regional economic imbalances; promote citizen's participation in the economy, indigenous entrepreneurship and foreign investments through joint ventures.[1] Further, state corporations addressed emerging issues of national interest such as Kenya BioVax Institute and facilitated

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[1] Ministry of Planning and National Development (1965) Sessional Paper No. 10 on African Socialism and its Application to Planning in Kenya, Government Printer, Nairobi. Available at http://repository.kippra.or.ke/handle/123456789/2345

untapped opportunities such as those in the Blue and Digital Economies.[2]

Parastatals played a major role in providing essential services and infrastructure development.[3] They were responsible for sectors such as energy, telecommunications, transportation, and water supply. However, over time, it became evident that many of these parastatals were inefficient and faced financial challenges.[4]

History of Privatization

A comprehensive review of the Public Enterprises Performance was carried out in 1979 (the Report on the Review of Statutory Boards)[5] and 1982 (the Report of the Working Party on Government Expenditures).[6]

The Report on Review of Statutory Boards[7] pointed out that:

- The expansion of the Parastatal sector did not result in the development of efficient systems and services;
- There was clear evidence of prolonged inefficiency, financial mismanagement, waste and malpractices in many parastatals;

[2] The National Treasury& Economic Planning (2023) *Privatization Programme*
[3] Privatization Commission (2008) Privatization Programme, Government Printer, Nairobi.
[4] Ibid, Note 2
[5] Ministry of Finance (1979) Report on Review of Statutory Boards, Government Printer, Nairobi.
[6] Working Party on Government Expenditures (1982). Report and Recommendations. Government Printer, Nairobi.
[7] Ibid, Note 1.

- Government investments had largely been at the initiative of private promoters with government being brought in either as an indispensable partner or to undertake rescue measures;
- Many of the parastatals had moved away from their primary functions, especially the regulatory boards most of which had translated their regulatory role into executive one, resulting in waste and confusion; and
- There was danger of over-politicizing production and distribution through establishment of too many parastatals.

The Report on the Working Party on Government Expenditures[8] concluded that productivity of state corporations was quite low despite heavy state investments resulting in long-term fiscal problems. The report observed that:

- Nationalization had remained merely presentational through government ownership;
- State corporations' operations had become inefficient and unprofitable, partly due to multiplicity of objectives;
- Existence of parastatals in commercial activities had stifled private sector initiatives; and
- Many of the joint ventures had failed, requiring the Government to shoulder a major financial burden.

The Report on the Working Party on Government Expenditures concluded that some of the resources diverted to the government to finance the state corporations' activities could have contributed more

[8] Working Party on Government Expenditures (1982). Report and Recommendations. Government Printer, Nairobi.

to national development if these state corporations were left in the private sector.[9] The report recommended that:

- The Government should act as a creator of favorable setting within which people can develop themselves and the economy;
- The Government should divest from its investments in commercial and industrial enterprises to transfer active participation to more Kenyans through participation in shareholding;
- The Government should reduce exposure to risk in areas in which the Private Sector can assume risk without government intervention;
- The Government should dismantle some of the existing administrative hurdles which discourage private sector initiative and provide needless opportunities for corruption; and
- The Government should reorganize legal and institutional framework regarding monitoring and supervision of parastatals.

Following the two reviews, government turned to privatization, which started in the 1980s and gained momentum in the 1990s as part of the Structural Adjustment Program. [10] The objectives of privatization in Kenya were to improve efficiency, attract private

[9] Ibid, Note 7.
[10] Republic of Kenya, Economic Reforms for 1996-1998: The policy framework paper prepared by the government of Kenya in collaboration with International Monetary Fund and World Bank.

investment, increase competitiveness, reduce the fiscal burden on the government, and stimulate economic growth.[11]

First wave of Privatization: (1992 - 2002)

In July 1992, through the issuance of the Policy Paper on Public Enterprise Reform and Privatization, the Government outlined the scope of the Public Sector Reform Programme, the institutional framework and the guidelines and procedures for privatizing Public Enterprises.[12] The Policy Paper identified 240 commercial PEs with public sector equity participation and classified them into two categories:[13]

1. 207 Non-strategic commercial PEs which were to be privatized; and
2. 33 Strategic Commercial PEs which were to be re-structured and retained under public sector control.

By the end of the first phase of the privatization programme in 2002, most of the non-strategic commercial enterprises had either been fully or partially privatized.[14] At that time, the direction of thinking regarding restructuring and retention of a number of strategic corporations under Government operation and control had also changed due to: inadequacy of public resources to finance the requisite investment in infrastructure facilities; the need to arrest

[11] Department of Government Investment and Public Enterprises, (1998) *Policy paper on Public Enterprises Reform and Privatization,* Government Printer, Nairobi.
[12] Department of Government Investment and Public Enterprises, (1992) *Policy paper on Privatization and Public Enterprise Reform Programme*, Government Printer, Nairobi.
[13] Ibid, Note 12.
[14] Privatization Commission, Completed Privatizations 1992-2002, Available at www.pc.go.ke

continued deterioration in infrastructure services; lesson from other countries which had succeeded in improving their infrastructure services through Public Private Partnerships; and restructuring which resulted in separation of commercial activities from regulatory functions, making it possible to privatize commercial activities while ensuring Government continued presence in the privatized sectors through establishment of strong legal and institutional regulatory frameworks.[15]

The procedure in the First phase

The privatization process in Kenya involved several steps:[16]

1. First, the Parastatal Reform Programme Committee identified the parastatals and public entities to be privatized. The enterprise selection criteria will be that the government has majority ownership, the firm requires minimal restructuring before sale, the firm is profitable, the enterprises are selected from diverse sectors in the economy, the financial and operational records of the firm should be up to date and available, the divesture should require minimal regulatory adjustments and result in minimal redundancies, and the sale should result in a reduction of budgetary drain.
2. Second, the Committee conducted valuations of these entities to determine their worth and potential for profitability through preparation of memoranda on the technical issues, financial issues, legal issues, marketing prospects, asset

[15] Ibid, Note 14.
[16] Department of Government Investment and Public Enterprises, (1998) *Policy paper on Public Enterprises Reform and Privatization,* Government Printer, Nairobi.

valuation, operational and financial projections and sensitivity analysis.

3. Third, the Parastatal Reform Programme Committee developed a plan for the privatization process, including the method of sale (such as public offering on the Nairobi Stock Exchange, sale of shares by private sector placement, negotiated sales, employee/management buyout, sale of enterprise assets including liquidation), the timeline for the sale, and the conditions for potential buyers.
4. The Parastatal Reform Programme Committee then began the marketing and promotion of the privatization program to attract potential investors followed by the publication of a tender notice in local and foreign publications inviting prospective bidders to obtain the sales prospectus.
5. Interested parties were invited to submit bids or proposals, and the government evaluated these proposals based on criteria such as capability, experience, financial standing, and proposed price or offer.
6. After the evaluation, the Parastatal Reform Programme Committee on the basis of the recommendation by the appointed Tender Evaluation Committee selects the preferred bidder and entered into negotiations for the sale of the assets or shares.
7. The final step was the execution of the sale agreement and the transfer of ownership from the government to the private sector entity.

The process is guided by principles outlined in the 1998 reform report[17] namely: competitiveness as no purchaser would obtain an unregulated monopoly or special protection; government as minority

[17] Ibid, Note 16 .

would not exercise any specific or extraordinary voting rights except on a limited, predetermined and well defined areas; privatization would be on a cash basis only except where shares are sold to the workforce; inclusivity as no class of purchasers would be excluded. The sale of a portion to another public institution is not considered privatization. All privatization transactions will also be conducted in an open and transparent manner including publication of relevant disclosures by both the firms to be sold and investing firms, valuation of the firm to be sold, bidding procedures and criteria and the terms of the sale.[18]

After the first wave of privatization, the government established the State Corporations Advisory Committee (SCAC)[19] to streamline the management of the state corporations by reviewing the affairs of state corporations and making recommendations to the government. However the performance of most of the corporations continued to deteriorate, primarily because of continued reliance on limited public sector financing which was inadequate to meet the sector's needs, over employment, which caused most of the revenue to be used in payment of salaries, non-viable ventures which siphoned away resources from the enterprises, corruption and mismanagement in general. [20] In addition most of the parastatals were under capitalization from the time of incorporation as they were mainly financed from loans without due regard to the establishment of a strong financial base.[21] Most of them also continued to spread their

[18] Ibid, Note 16.
[19] Section 26, State Corporations Act, Cap 446.
[20] Report No. 21409: Kenya: World Bank Assistance Evaluation Report.
[21] Mitine, G, The Privatization and Parastatal Reform Programme (2000): Kenya experience

resources thinly due to multiplicity of objectives and poor accountability.[22]

Second wave of Privatization: (2003 - 2008)

Under the Economic Recovery Strategy for Wealth and Employment Creation (ERSWEC) 2003-2007, the Government implemented a number of key privatization transactions. These included the Kenya Electricity Generating Company (KenGen) through Initial Public Offer (IPO), the concession of the Kenya Railways operations, Mumias Sugar Company Second Offer, Kenya Reinsurance Corporation IPO, Sale of 51% Telkom Kenya shareholding to a strategic partner and the Safaricom IPO. Through these transactions, the country mobilized over Kshs.80 billion which was used to support the country's recovery and overall development agenda.[23]

The procedure in the Second phase

The procedure for privatization remained the same but to further streamline it, the government enacted the Privatization Act in 2005.[24] The Act established the Privatization Commission which was mandated formulating and implementing privatization programmes and privatization proposals replacing the Parastatal Reform Programme Committee.[25] The Act formalized the privatization procedure, requirements for privatization proposals and methods of privatization.[26] The Act further required the approval of Cabinet and Parliament for the implementation of privatization programmes and

[22] Ibid, Note 18.

[23] Privatization Commission (2008) Privatization Programme, Government Printer, Nairobi.

[24] Privatization Act Chapter 485 C (2005) (Rev 2009)

[25] Sections 3 and 4, Privatization Act 2005.

[26] Parts III and IV Privatization Act 2005.

proposals in order to safeguard public entities from corrupt schemes.[27]

Proposed Alternative to Privatization: Parastatal Reforms proposed by the Presidential Taskforce: (**2013 - 2022**)

The fourth President Uhuru Kenyatta in a reversal of the previous regimes advocated for the rehabilitation of parastatals. To this end, he appointed the Presidential Task Force on Parastatal Reforms in 2013.[28] The report recommended that parastatals be reduced from 262 to 187 of which a total of 42 parastatals, mostly in the agricultural sector should be dissolved, 28 merged, 22 others have their roles transferred to other institutions and 21 agencies to be reclassified as professional bodies.[29] The idea was to rationalize the operations of the state-owned enterprises by removing overlaps, duplication and redundancies to eliminate wastage of public funds, enhance efficiency and bolster productivity.[30] However, the government has only managed to merge parastatals in agriculture, by establishing the Agriculture and Food Authority.[31] The only real impact of the taskforce was the development of *Mwongozo*, the code of governance for state corporations. This is due to institutional infighting, lack of political goodwill, lack of cooperation from the Treasury and the

[27] Sections 17(2) and 23(2) Privatization Act 2005.
[28] https://www.scac.go.ke/presidential-taskforce
[29] Report of the Presidential Task Force on Parastatal Reforms (October 2013), <*https://www.scac.go.ke/2015-02-16-09-56-36/reports?download=1:report-of-the-presidential-taskforce-on-parastatal-reforms*> accessed on 7th December 2023.
[30] Ibid, Note 29.
[31] Established by the Agriculture and Food Authority Act, No. 13of 2013which consolidates laws on regulation of agriculture.

failure to pass the Government Owned Entities Bill and the National Sovereign Wealth Fund Bill were drafted to facilitate the mergers.[32]

Proposed Third phase of Privatization: (2023 onwards)
The government of Kenya entered into extended fiscal arrangements with the International Monetary Fund in exchange of the government committing to reform more than 35 State Owned Enterprises.[33] In this line, the Ministry of Treasury released a statement on the 27th November 2023, revealing the government's plan to dispose of 11 parastatals through privatization.[34] The 11 include: the Kenyatta International Convention Centre, Kenya Pipeline Company, New Kenya Cooperative Creameries, Kenya Seed Company Limited, National Oil Corporation of Kenya, Kenya Literature Bureau, Western Kenya Rice Mills Ltd, Numerical Machining Complex Limited, 35% of Vehicle Manufacturers Limited, Rivatex East Africa Limited and the Mwea Rice Mills Ltd.[35]

To facilitate this new wave of privatizations, the president enacted the Privatization Act 2023.[36] This Act proposed replacing the Privatization Commission with the Privatization Authority and mandated it with implementation of privatization programmes.[37] The major and hotly contested changes from the 2005 Act are that the new act proposes that it removes the requirement of parliamentary approval of the Privatization Authority, that the cabinet secretary has

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[32] The National Treasury & Planning, (July 2021) Press Release: Update on Reforms of State Corporations
[33] International Money Fund Press Release No. 23/395. Available at https://www.imf.org/en/News/Articles/2023/11/15/pr23395-kenya-imf-reaches-sla-sixth-rev-ecf-rev-rsf-concludes-2023-aiv-consultation
[34]The National Treasury& Economic Planning (2023) *Privatization Programme*
[35] Ibid, Note 30.
[36] Privatization Act 2023, No. 11 of 2023
[37] Sections 8 and 9, Privatization Act 2023, No. 11 of 2023

unfettered discretionary powers to identify public entities to be included in the Privatization program without public participation and oversight, and that privatization proposals are approved by the Board of the Authority with the concurrence of the Cabinet Secretary without approval by cabinet or parliament.[38] These provisions of the Act however have been contested in court and conservatory orders being issued by Justice Mwita.[39]

Privatization: Challenges and Opportunities in Kenya

The opportunities posed by privatization include:[40]

1. The improvement of infrastructure and delivery of public services by the involvement of private capital and expertise.
2. The reduction of the demand for government resources. As the government would stop pumping resources into these public entities, hence funds would be diverted into development. The proposed sale of 11 state companies is projected at saving the government 500 billion shillings in budgetary allocations.
3. The generation of additional government revenues by receiving compensation for privatization. Although numerous enterprises were privatized during the first, the impact on the economy was limited because: most of the enterprises privatized under this Phase were relatively small and self-sufficient, and the privatization programme lacked procedural and institutional framework. The second phase

[38] Operation Linda Jamii (Operation Linda Gatuzi) v AG & National Assembly of Kenya, Constitutional Petition E491 of 2023
[39] Ibid, Note 32.
[40] Ibid, Note 16.

was more impactful, generating over 80 billion shillings as larger entities with significant value were privatized.

4. The improvement of the regulation of the economy by reducing conflicts between the public sector's regulatory and commercial functions.
5. The improvement of the efficiency of the Kenyan economy by making it more responsive to market forces.
6. The broadening of the base of ownership in the Kenyan economy from government to more diverse ownership.
7. The enhancement of the capital markets.

Privatization has also faced significant challenges such as:[41]

1. Government interference. This has been very prominent in entities where the government is a minority shareholder as seen in Mumias Sugar, East African Portland Cement and recently some attempts in Safaricom PLC. These actions often result in ultra vires actions such as the president appointing Board chairpersons despite being the majority, or attempts to dilute majority shares.
2. Gaps in legislation. There are gaps in legislation that should be addressed to streamline privatization process such as mandatory requirement for public participation, clearly delineating the rights of investors and powers of government in minority, lack of adequate controls by giving the cabinet secretary in charge of Treasury discretionary powers to approve proposal and disposal of proceeds.

[41] Trendy Consulting International Limited (March 2020), Comparative Analysis of Privatization and Government Divesture: Challenges and Opportunities, Privatization Commission.

3. Lack of clearly defined processes and an effective communications strategy also exposed the Programme to accusation of corruption.
4. There was also limited participation by individual Kenyans in most of the transactions due to the transaction methods applied. Further, there isn't a requisite minimum citizen participation requirement.
5. Risk of natural monopolies despite operation in a free market that promotes competition and consumer choice. A good example would be KPLC which is a statutory monopoly. It also results in loss of control by the government and inversely an increase in the market power of a few private companies.
6. Privatization is also primarily profit driven hence it sacrifices quality, cherry picks only profitable services and may result in a fragmented, wasteful system.

Conclusion

The privatization process is aimed at addressing the inefficiency and financial challenges faced by these entities, improve efficiency, attract private investment, reduce fiscal burden on the government, increase competitiveness in the market, and stimulate economic growth.[42] However, the process faces challenges in the legislative framework and balancing the financial incentives and the benefits to common citizens.

Despite these challenges, privatization has led to improved performance, technology advancements, and new management practices in many cases. Overall, privatization has had mixed results in Kenya.

[42] The National Treasury& Economic Planning (2023) *Privatization Programme*

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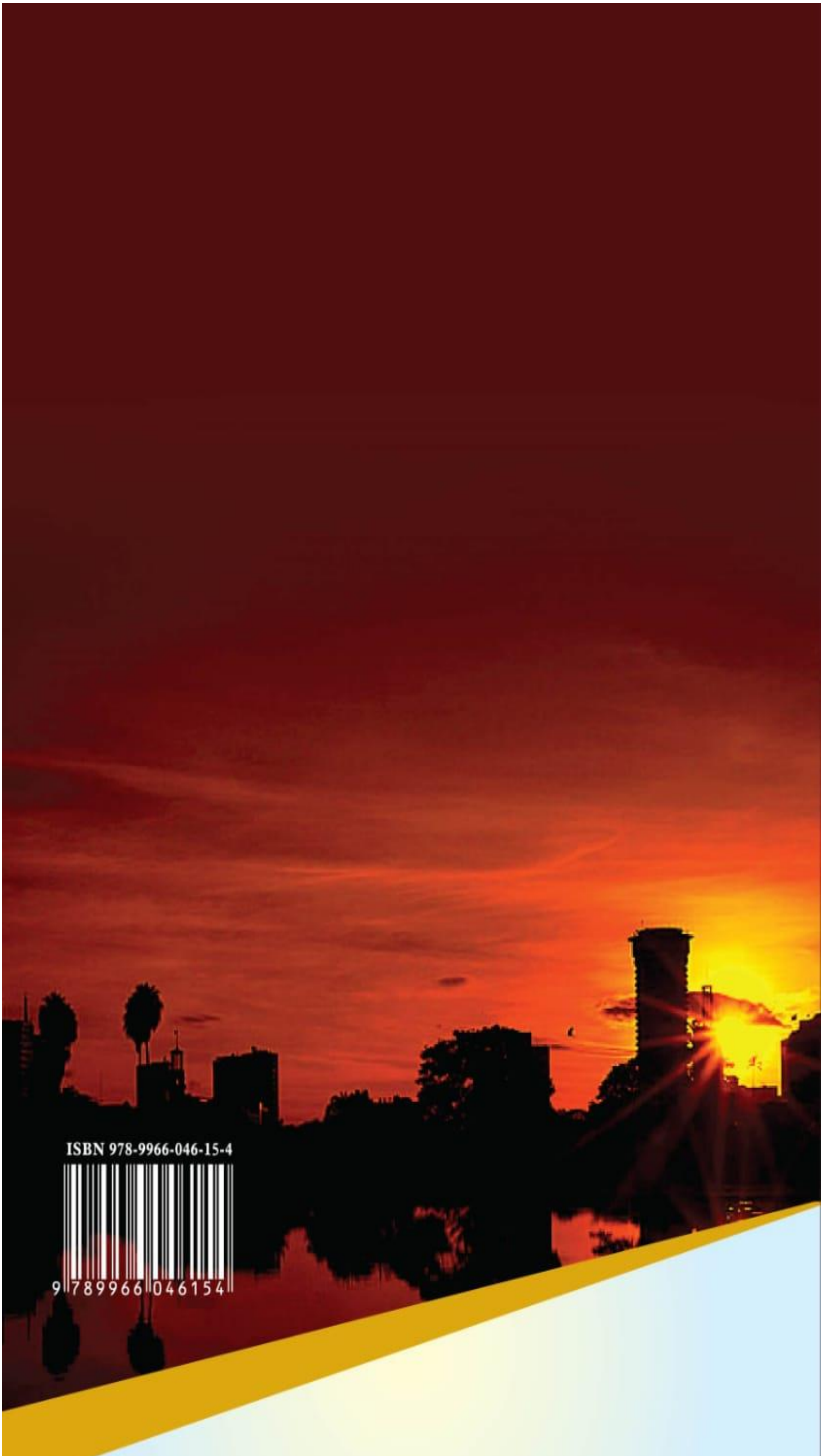

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