

THE DYNAMICS OF PRIVATIZATION POLICY AND THE NIGERIAN ECONOMY

O. O. OVAT

(Received 12, March 2007; Revision Accepted 11, May 2007)

ABSTRACT

The paper examines the impact of the privatization policy on the Nigerian economy. It employs relevant theoretical paradigm and literature on the subject matter, and uses OLS estimation method in its empirical analysis. The findings show that the policy has impacted positively on the Nigerian economy in terms of increase in the level of output. It also shows that the policy of interest rate deregulation as induced by SAP to complement the privatization policy has not achieved the desired objective. The paper concludes with some recommendations which among others, include, the need for a "guided deregulation" of interest rate and the foreign exchange market, encouraging the establishment of engineering industries to fabricate different designs of machines for use by the privatized enterprises and the implementation of the privatization policy with honesty and transparency.

KEYWORDS: Privatization, Impact, Nigerian Economy, Foreign Exchange, Productivity.

1. INTRODUCTION

Of recent, most developing economies have been characterized by extensive privatization programmes. The idea that private ownership has advantages over public ownership in a market environment is not new. Adam Smith, in 1776 highlighted the reduction in the public sector's borrowing requirements and the improvement in efficiency that can be expected when ownership of public enterprises is transferred to the private sector. Thus, privatization which is the transfer of public assets and service functions to the private sector either by outright sale or contracting out, has been given strong backing by the classical theoretical paradigm. The Central idea according to the classical theorists is for such, enterprises to achieve efficiency, effectiveness and viability. Privatization has indeed, in recent history of economic policy shift, gained tremendous prominence and has become one of the most revolutionary innovations to both developed and developing countries alike.

The Keynesian revolution of the 1930s encouraged many developing countries including Nigeria to embrace on a large – scale, government interventionist policy in running and management of public enterprises (Ndebbio, 2003). Thus, given the oil boom of the 1970s in Nigeria the economic activities of public enterprises, especially those within the social services and utilities sectors proliferated far beyond the orthodox domain of the above sectors into agriculture, mining, manufacturing, banking and finance, commerce etc. (Ayodele, 1999).

The above scenario is equally true of sub-Saharan Africa, as a continent. With the exclusion of South Africa, Fadahunsi (1986), conservatively estimated the existing public enterprises in the region to be 5000. Given their sizes, numbers, problems of management and concept, there have been growing agitations by scholars, that their role, aims and objectives be clearly defined because, they seem to have become "organizational monsters" that may devour their human, material and financial resources at a pace beyond the widest quest of present generation of public enterprises management (Siyan and Ekhaton, 2005).

Corroborating the expansion and attendant problems of public enterprises in Nigeira, Obasanjo (1991), in his inaugural speech at National Council on privatization and commercialization observed that, there has been a proliferation of state owned enterprises over the years, covering a broad spectrum of economic activities, from steel plants and petrochemical, through banks and hotels, to mass transit and abattoirs. He continued, "it is estimated that

successive Nigerian Governments have invested up to N800 billion in public owned enterprises. Annual returns on this huge investment have been well below 10 percent." These inefficiencies and, in many cases huge losses exert severe pressures on the public treasury.

Obasanjo (1999), further remarked that state enterprises suffer from fundam ental problems of defective capital structure, excessive bureaucratic control or intervention, inappropriate technology, gross incompetence and mismanagement, blatan corruption and crippling complacency which monopoly engenders. All these inadequacies adversely affect economic growth and development or take a heavy toll on the national economy. Consequently, there has been unabated hue and cry by the general public on the need to make public enterprises more efficient. This efficiency, the proponents of privatization strongly believe, is in privatizing the state owned enterprises.

In tandem with the position held by Obasanjo (1999), the vision 2010 committee as cited in Siyan and Ekhaton (2005), observed that the Federal Government investment in public enterprises stood at over US\$100 billion in Nigeria in 1996. The return on these investments averages less than 0.5 percent per annum. In the same vein, the technical committee on privatization and commercialization (TCP) in its survey observed that public enterprises account for between 30 and 40 percent of fixed capital investment and about 50 percent of formal sector employment. Paradoxically, only about 400,000 people are engaged in economic activities in the public enterprises.

The popularity of privatization as portrayed by its proponents reflects different hopes. To many, their hopes are anchored on efficiency. It is their belief that privatization will bring about increase in output, improvement in quality of goods and services and reduction in unit costs. Others hope that privatization could bring about fiscal discipline in terms of curbing the growth in public spending and hence raise revenue to reduce public debt. While in some quarters, it is further hoped that it would give the citizens a sense of belonging and make them stakeholders in their own economy by broadening the base of ownership and participation in the society. This perhaps may be responsible in recent times, for the global switch from a growth – retarded state ownership of public enterprises to a more competitive market oriented system drive.

By and large, the privatization policy, if properly directed and executed could achieve or realize the different hopes expressed about it. A lot of emphases have been given

government in Nigeria. The point of departure of this study therefore is to carry out an impact assessment of the privatization policy on the performance of the Nigerian economy in terms of productivity, to add to the existing body of knowledge. Meanwhile the paper is organized in the following sequence: Section one has been the introduction. Section two discusses some theoretical issues and literature review relating to privatization. Section three provides the methodology. Empirical results and analysis constitute section four. Section five provides concluding remarks.

2. THEORETICAL ISSUES AND LITERATURE REVIEW

Privatization of public enterprises is anchored on the classical theorizing. According to this school of thought, government should keep its hands off business and allow the forces of demand and supply and competition to regulate the economy. The classical view thus favours capitalism which stresses the ownership and control of means of production by the private sector.

Adam Smith, the founder of the classical school of thought advocated privatization more than two hundred years ago as a means of eliminating waste and maximizing the value of assets. His views on privatization were contained in his book - *The Wealth of Nations*. In it, he maintained that government should only saddle itself with the following responsibilities:

- (i) Defence of its citizens against external aggression.
- (ii) Establish and manage the institutions for administration of justice.
- (iii) Maintain public works, and institutions that cannot be operated on the basis of profit.

To Smith, each man is the best judge of his interest. People should be left free to pursue their self interest. Each person, when allowed to pursue his free-will, would do so by furthering the common good of the society. In his views, each individual is led by an incincible, invisible hand to promote an end that was not part of his intension (Essia, 2005). Adam Smith believed in the existence of an inherent natural order that is superior to any order constructed or created by man. Government intervention in the economy should be limited to the aforementioned responsibilities, anything outside that is harmful and distort the free flow of the natural order which is guided by price mechanism or what Smith termed the "invisible hand". Price mechanism, the hall mark of capitalism to Smith, facilitates exchange.

To the classical theorists, the rationalization of public enterprises, which is the integral component of privatization is geared towards achieving greater economic efficiency. Thus decreased involvement in public sector enterprises in recent times by government tends to promote capitalism in Nigeria (Ndebbio, 1991).

A lot of studies have been concluded on privatization policy. Okorie (2005) maintained that privatization was first experimented in Britain in a small scale between 1970 and 1974. Following the success it recorded, Thatcher's government after 1970, embarked on a large scale privatization programme in Britain with a focus on electricity, gas and telecommunications. As argued by Okorie (2005), it was the success of the policy in Britain that made other countries to emulate it. Also, it was based on this success story that made the World Bank to encourage developing countries including Nigeria to embrace it.

In Nigeria, Ogunna (1999) traced the history of efforts made by successive government towards implementing privatization policy to 1964. In his words, privatization becomes imperative as a result of "embarrassing observations that public enterprises in the Federation have been performing below acceptable standards, some have failed totally, and others have succeeded to put tax-prayers money to the drains". He observed that it was Babangida's government that made the first practical step towards implementing privatization of some public enterprises and introduced partial

commercialization. Preceding governments' efforts only stopped at committees level.

Ndebbio (2003), maintained that privatization policy was unfolded in Nigeria by Decree No. 25 of 1988 which legalized commercialization and privatization of public enterprises in the country. He stressed that privatization policy was being induced by the World Bank/IMF supported Structural Adjustment Programme (SAP), introduced by the Babangida administration in June 1986. SAP, according to him, was a revolutionary policy instrument designed to achieve both external and internal balances under the free play of market forces. Thus privatization of public enterprises is one of the most important SAP's classical trimmings. To Ndebbio (2003), some of the aims of the privatization policy in Nigeria include improving efficiency as well as investment prospects for the privatized industries.

Siyan and Ekhaton (2005) shared the same opinion with Ndebbio (2003) and argued along the lines of the classists that privatization brings about competition from competent and efficient indigenous and foreign investors, which in turn promote efficiency and tremendously increase productivity. In their view, the chain reaction will extend to, creation of jobs, innovation, increase per capita income of the people, improvement in the standard of living in general and down turn in inflation and poverty rates. Their position is informed by the fact that a retrospective examination of public enterprises in Nigeria shows that they are characterized by gross abuses, inefficiency, and low returns to investment. For example, according to the report submitted by the secretary to the federal government in 1985 to the Head of State and commander in Chief of the Armed Forces, Siyan and Ekhaton (2005), maintained that commulative government investments in state enterprises from 1960 to 1985 amounted to N25billion with less than N1.0billion realized within same period as returns (profits). This unsavory scenario calls for urgent and immediate reformation and privatization of all public enterprises as the best option to save the nation.

Indeed, the past also proved that, the management of public enterprises is plagued with "political and budgetary constraints, insecurity of tenure of office, unsatisfactory reward system that led to job dissatisfaction with frustration, lack of commitment and underpayment when compared with what is applicable in the private sector. Other common features of public enterprises in Nigeria are, sycophancy, lobbying, bribery, corruption, embargo on promotion and employment (Fubara, 1996)".

3. METHODOLOGY:

In carrying out an impact assessment of the policy of privatization embarked upon by successive governments on the performance of the Nigerian economy, performance, depicted by the level of productivity in the economy, the study adopts an empirical analysis. The analysis uses multiple regression framework with OLS estimation technique. Time series secondary data are used in this study. They are basically extracted from the Central Bank of Nigeria Statistical Bulletin (Various issues). The scope of the study is limited to the Nigerian economy, Annual data between 1981 and 2004 are used in the regression analysis.

MODEL SPECIFICATION

The classical theorists have stressed the relevance of private ownership and control of means of production as opposed to government control and ownership of such means of production. The antidote that is prescribed to ailing economies in recent times that are desirous to achieve rapid growth and development tilts towards policy measures or instrument designed to promote classical theorizing which is embedded in the interplay of market forces. One of such policy packages was SAP, introduced in Nigeria in 1986 with privatization and commercialization of public enterprises, interest rate deregulation, establishment of market based foreign exchange system, reduction in the level of imports

(especially consumer goods), among others as its main objectives. These policy instruments or objectives as induced by SAP are closely interwoven and reinforce and complement one another. They are basically geared towards lessening the dominance of unproductive investment in the public sector and improve the sector's efficiency with the ultimate goal of enhancing the overall productivity of the economy (Federal Republic of Nigeria, 1986; Ndebbio, 1991).

The impact assessment of the dynamics of privatization policy in the Nigerian economy is therefore viewed in terms of the effect of the above policy package/instruments on the level of output in the economy. In tandem with the classical theoretical paradigm as discussed in section two, the following model is specified.

$$GDP = a_0 + a_1PRIV + a_2FOREX + a_3MRR + a_4IMP + \mu \quad (3.1)$$

Where GDP = Gross Domestic Product (used to proxy output)

PRIV = Privatization (Captured by a dummy variable)

FOREX = Foreign Exchange

MRR = Minimum Rediscount Rate (Proxy for interest rate)

IMP = Imports (especially capital goods)

μ = Stochastic error term

The following are apriori expectations of the coefficients of the model: $a_1, a_2 > 0$; $a_3 < 0$; $a_4 > 0$

4. EMPIRICAL RESULTS AND ANALYSIS

The summary of the regression results is presented as follows:

$$GDP = 60884.61 + 12892.49PRIV + 314.7FOREX + 847.01MRR + 0.011114IMP$$

(11.41622)	(2.310811)	(7.76529)
(1.614326)	(2.345741)	

$$R^2 - \text{Adjusted} = 0.90786 \quad F\text{-ratio} = 57.6794 \quad D.W = 1.262142$$

Where values in parentheses are t-values.

The results presented above are analyzed under three criteria, namely, economic apriori, statistical and econometric criteria. Under economic apriori criteria, the positive sign of the estimated coefficient of privatization variable is consistent with economic apriori expectation in consonance with the postulation of the classical theorist. The classists believe that privatization of public enterprises brings about efficiency, competition, innovation and increase in output. Foreign exchange variable (FOREX) has a positive sign. An increase in foreign exchange will facilitate the ease of importing capital goods which are used by the privatized enterprises for production. This has the effect of boosting output. So, the positive sign of the coefficient of foreign exchange variable is consistent with apriori expectation. Minimum Rediscount Rate (MRR), proxy for interest rate is also positive. This does not seem to be consistent with apriori expectation. Interest rate (cost of capital) is a major determinant of investment and hence output. An increase in interest rate discourages investment and hence adversely affect output. On the other hand, a decrease in interest rate encourages investment and hence boosts output. The coefficient of import (capital goods) is positive and consistent with economic theory. Nigeria as a developing country is import dependent (especially capital goods imports). These privatized public enterprises make use of imported raw materials and machinery for production. An increase in these capital goods importation will lead to an increase in output.

Under the statistical criteria, all the explanatory variables are statistically significant both at 5 percent and 10 percent levels respectively, except interest rate variable (MRR) that is not. This implies that interest rate deregulation embarked upon by the monetary authorities to complement the privatization policy as induced by SAP in 1987 has not contributed to increase in output in Nigeria. Apart from interest rate, all the other explanatory variables in the empirical model exert significant influence on output (GDP). The model fits the data well, as 91 percent of variation in the dependent variable (GDP) is explained by the explanatory variables. Moreover, the overall model is statistical significant as indicated by the

calculated value of the F-statistic. The value of F-calculated of 57.67941 > the value of F-tabulated of 2.78 at 5 percent level.

The estimated model viewed in terms of econometric criteria which tests for the existence or otherwise of serial or autocorrelation shows that the test was inconclusive, as the calculated Durbin-Watson Statistic of 1.3 falls within the inconclusive region. Thus, we cannot say with certainty whether or not autocorrelation exists.

5. CONCLUDING REMARKS

Keynesianism, which became popular in the wake of the great depression of the 1930s encouraged government intervention in the running and management of public enterprises, and was seen as a panacea for making a depressed economy achieve rapid growth and sustainable development. But the woeful performances of these public enterprises, typified by gross inefficiency, declining productivity, among others, have shown that Keynesian prescription of public ownership and control of enterprises as a veritable means of achieving rapid growth and development is not sacrosanct.

This ugly scenario of the poor performances of public enterprises in Nigeria has made policy makers to have a shift in emphasis in favour of privatization policy since 1988.

The shift in emphasis, as shown in the study's findings seems to have paid off. The coefficient of privatization is positive and statistically significant. The empirical results show that a 1 percent increase in privatization of public enterprises leads to 12982.49 percent increase in output. The study's findings also revealed that the policy of interest rate deregulation as induced by SAP to complement the privatization policy has not contributed to increase in output. Nigeria had a regulated interest rate structure until August 1, 1987 when it was deregulated. The main objectives for deregulating the interest rate were among others, to stimulate foreign capital inflow, induce Nigerians to repatriate flight capital and encourage savings as well as restrict credit expansion thereby curbing inflation. This policy as shown by the study's findings has not however influenced growth in output in Nigeria. The net social effect of interest rate deregulation is therefore meaningless.

For the policy of privatization to achieve its set objectives and sustain its positive impact on productivity as shown by the empirical findings, the study concludes with the following recommendations.

There should be a "guided deregulation" of interest rate by the monetary authorities. Interest rate should not be completely allowed to be determined by market forces. Given that many small and medium scale firms may not be able to borrow and invest in the privatized public enterprises.

(i) There should also be a "guided deregulation" of the foreign exchange market. Before now, there was the general consensus that the national currency (the naira) was over valued. The quest therefore was to find a realistic exchange rate for the naira as conceived by SAP. This precipitated a wholesale depreciation of the naira by allowing the exchange rate to be completely determined by the forces of demand and supply. The belief then was that a realistic exchange rate would encourage exports discourage imports, reward actual production, marginalize middlemen to some extent, and, in the long run lead to more rational utilization of scarce resources (Ndebbio, 1991). Consequently, the value of the naira became despicably low, resulting in high cost of importation of raw materials and machines for production. Guided deregulation of the exchange rate becomes imperative, as it will go a long way in appreciating the value of the naira thereby reducing the cost of capital goods importation which are used by the privatized public enterprises for production.

(ii) The government should, as a matter of urgency, encourage the establishment of engineering industries to fabricate different designs of adaptable machines to be used in the privatized enterprises.

This will go a long way in ameliorating the problem associated with machinery importation abroad, especially as devaluation has made the value of the naira to be very low. This will also conserve the country's foreign exchange and improves her balance of payments.

(iii) Above all, the privatization policy should be properly directed and implemented with a high degree of honesty and transparency.

If these and other desirable measures are taken, it is the considered opinion of the paper that the gains already recorded by the privatization policy would be sustained and improved upon.

REFERENCES

- Ayodele, A., 1999 "Issues in the Privatization of Public Enterprises in Nigeria" CBN Bullion, 26, (56): PP. 12-17 September.
- Essia, U., 2005. Issues In Modern Economic Thought, The Evolution of Economics: Facts, Phantoms and Fictions. Calabar: Saesprint Publishers. Vol. 3
- Fadahunsi, O., 1989. "Public Enterprises Management in Africa". A Paper presented at Expert Group meeting of Africa Association for Public Administration (ASCON), Badagry, National Council on Privatization Guideline on Privatization, 2000, Abuja.
- Federal Republic of Nigeria, 1986. Structural Adjustment Programme for Nigeria July 1986 - June 1988, Lagos, Federal Government Printer.
- Fubara, B. A., 1984. Strategy Formulation and Political Intervention in State Owned Companies in LDC's RVB Research Paper.
- Ndebbio, J. E. U., 1991. "Industrial Development Policies/Incentives and their Impact on The Nigerian Economy". In: Ndebbio, J. E. and Ekpo, A. H. (eds), The Nigerian Economy at the Cross Roads: Policies and Their Effectiveness Calabar: Unical Press.
- Ndebbio, J. E. U., 2003. "Towards Privatization and Industrial Investment Priorities for Sustainable Growth and Development in Akwa Ibom State of Nigeria", Nigerian Journal of Economics and Development Matters 1, (1): PP 45-60 June.
- Nyong, M. O., 2005. International Economics: Theory Policy and Applications, Calabar: Wusen Publishers.
- Obasanjo, O., 1999. Speech at the Inauguration of National Council on Privatization.
- Ogunna, A. E., 1999. Public Administration in Nigeria: Theory and Practice, Owerri Great Versatile Publishers.
- Okorie, P. U., 2005. Nigeria's Privatization Policy (The Imperative of Quality Education), Aba: PUO Ventures.
- Siyani, P. and Ekhator, V., 2005. "Restructuring the Nigerian Economy Through The Privatization of Public Enterprises: An Impact Analysis of the National Electric Power Authority (NEPA)" Lagos Organization Review 1, (1): PP 32-34 August.
- Smith, A., 1937. An Inquiry into The Nature and Causes of The Wealth of Nations Edwin Canaan (ed), New York: Modern Library.

APPENDIX

REGRESSION RESULTS

Dependent Variable: GDP
 Method: Least Squares
 Date: 19/02/07 Time: 02:23
 Sample: 1981 2004
 Included observations: 24

Variable	Coefficient	Std. Error	t. Statistic	Prob.
C	60884.61	5333.169	11.41622	0.0000
PRV	12892.49	5579.206	2.310811	0.0322
FOREX	314.6991	43.24852	7.276529	0.0000
MRR	847.0136	524.6855	1.614326	0.1229
IMP	0.011114	0.004738	2.345741	0.0300
R-Squared	0.923914	Mean dependent var	97430.13	
Adjusted R-squared	0.907896	S.D. dependent var	24626.62	
S.E. of regression	7473.846	Akaike info criterion	20.85926	
Sum squared resid	1.06E+09	Schwarz criterion	21.10469	
Log likelihood	-245.3111	F-statistic	57.67941	
Durbin-Watson stat	1.262142	Prob (F-statistic)	0.000000	