

PUBLIC INVESTMENT VERSUS PRIVATE INVESTMENT: THE CASE OF ZAMBIA

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Abstract

This paper highlights the growth dynamics of public and private investment in Zambia from 1964 to 2011. The evolution of the two components of investment in Zambia has been a product of market intervention and market-based policies. Initially, after its independence in 1964, the perpetuated market economy limited public investment growth to the basic infrastructural provision – for the first three years. However, the 1967 Mulungushi and the 1968 Matero nationalisation programmes brought about rapid expansion in public investment, especially from the early 1970s to the late 1980s. The market-based reforms that have been implemented in Zambia from 1991 have promoted private investment leadership – thereby, allowing public investment growth in economic activities that have complemented the private sector growth. Although private investment has grown to a position of economic dominance in Zambia, like many developing countries, the country still faces some challenges. These include inadequate and poor infrastructure, the high cost of human capital, cumbersome administrative procedures, and the high cost of financial capital.

Keywords: Public Investment, Private Investment, Zambia

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Introduction

While there is extensive economic literature on public and private investment, there is still no consensus on the specific relationship that exists between the two components of investment. Theoretically, an increase in public investment could have two different impacts on private investment. Firstly, the classical economists believe that an increase in public investment crowds out private investment – if: (i) It is deficit-financed, which would lead to higher capital market interest rates than the private sector could afford; and (2) if it is channelled towards the production of goods and services that are in competition with the private sector (Afonso and Aubyn, 2008).

Secondly, as Aschauer (1989a) and Munnell (1992) concluded, an increase in public investment crowds in private investment by creating a conducive environment for its growth, for example, by providing infrastructure, such as airports, highways, roads, health and educational facilities.

The empirical studies on the relationship between the two components of investment have yielded mixed results. For example, the empirical work of Aschauer (1989a, 1989b, 1993); Pereira (2001); Afonso and Aubyn (2008) showed that public investment promotes private investment. Conversely,

the studies of Graham (2002); Narayan (2004); Erden and Holcombe (2005, 2006); Rossiter (2002) have demonstrated that public investment automatically crowds out private investment.

In the Zambian scenario, both public and private investments have undergone different transformation patterns, since Zambia's independence in 1964. For the initial years following its independence, the Zambian government perpetuated the market economy, which saw the growth in private investment outpacing public investment. Growth in public investment was limited to the provision of the basic infrastructure that complemented the private sector. This growth strategy, however, ended when the Zambian government adopted the nationalist approach through the Mulungushi (1968) and Matero (1969) reforms.

This resulted in a sharp growth in public investment – primarily through a combination of State acquisitions of the private enterprises and the creation of the new State-Owned Enterprises (SOEs) (Mudenda, 1984). The economic difficulties that followed, however, forced the Zambian government to revert to the market economy. This was achieved through the privatisation of State enterprises, especially in those sectors where the private enterprises had higher marginal efficiency, leaving

the State with portfolios of economic activities that promoted the growth of private enterprises.

This adopted economic strategy is responsible for the high and sustainable Gross Domestic Product (GDP) growth rates that the Zambian economy has currently been achieving (Republic of Zambia, 2011). Therefore, the roles played by both public and private investment in shaping the economic growth path of the Zambian economy cannot be overemphasised.

However, despite the crucial roles played by both public and private investment in Zambia, the research work on the dynamism of the two components of investment is scanty (Kaunda, 1968; Bigsten and Mugerwa, 2000; and Musambachime, 1999). Hence, this paper aims to put under the spotlight the evolution of public and private investment in Zambia – by documenting their origin and growth trends since the independence of the Republic of Zambia in 1964 – through to 2011.

Public Investment in Zambia

Public investment in Zambia can be traced from its independence in 1964. Having inherited a market economy, public investment was limited to a few State-owned companies and statutory bodies. These included utility industries, such as in agricultural finance, railway, electricity, an Industrial-Development Corporation (INDECO), and marketing boards (Republic of Zambia, 1966a). Through INDECO, the growth in public investment was mainly in those sectors, which were basic to the economy, and which constituted the domestic monopolies, or which demanded higher investment of resources than the private sector could afford (Republic of Zambia, 1966b).

The rise to economic dominance of public investment has mainly occurred through the takeover of foreign-owned firms that happened between 1968 and 1970. These takeovers took place in two parts: the 1968 Mulungushi; and the 1969 Matero reforms. Through the Mulungushi reforms, the government nationalised the privately owned enterprises involved in different activities. These included: brewing, wholesaling and retailing, as well as the supply and manufacture of building materials (Kaunda, 1968).

Private enterprises in the mining sector were at least spared during the Mulungushi reforms. Through these acquisitions, INDECO's balance sheet grew to be one of the biggest Zambian Companies in the economy by the end of the 1960s (Mudenda, 1984).

The Matero reforms that followed in 1969 were more far-reaching than those of the Mulungushi. Here, privately owned enterprises in the mining sector were nationalised. The State took a controlling stake in the mining sector, which was dominated by foreign private enterprises. Since the mining sector was the backbone of the economy, the nationalisation

of this sector transformed the economy to that of a State-led model (Republic of Zambia, 1971).

In the financial sector, government market-interventionist policies were introduced through a combination of takeovers and the creation of new State enterprises. Only private enterprises – in the form of building societies and the insurance sub-sector – were nationalised. In the commercial financial sub-sector, privately owned banks were spared from acquisition by the government. However, the government established three banks that were to compete with the established and dominant foreign-owned banks.

For example, the Zambia National Commercial Bank (ZNCB) was set up in the 1970s. This bank grew to dominance, since it monopolised the banking services from the State-owned enterprises (Republic of Zambia, 1979).

The nationalisation programme in the agricultural sector was, however, somewhat less successful. The privately owned farms were still dominant – even in the aftermath of the nationalisation of some farms. The government still continued to depend on the expatriate privately owned commercial farms for the much-needed national food security (Republic of Zambia, 1979).

Upon the completion of the Mulungushi and the Matero reforms in the early 1970s, the parastatal sector was dominant in all the economic activities. For instance, INDECO's assets, the government SOE holding corporation, rose sharply from K49.9 million in 1966 to K 1009 million by 1979. Between 1973 and 1979, the parastatal sector contributed more than 50 per cent of growth; and it employed a third of the formal labour market (ZIMCO, 1985).

State-Owned Enterprise Economic Dominance through the Zambian Industrial and Mining Corporation

To oversee the growing parastatal sector, the Zambian Industrial and Mining Corporation (ZIMCO) was formed in 1970, taking over from INDECO. This meant that ZIMCO became a holding corporation with sub-holding companies, namely: INDECO; the Mining-Development Corporation (MINDECO); and the Financial-Development Corporation (FINDECO). Each sub-holding company was responsible for the portfolios in any given sector. The focus of MINDECO was on the group's mining assets.

INDECO's role was expanded to also hold portfolios in wholesaling and retailing. FINDECO was to hold and manage assets in the financial sector. With this expanded portfolio, ZIMCO's assets grew – to make it the biggest corporation in Zambia (ZIMCO, 1985).

Table 1. The net assets of ZIMCO by holding corporation in 1972

Sub-Holding Company	Share of Aggregate Group Net Assets before Consolidation in percentages
INDECO	19.7
MINDECO	78
FINDECO	0.5
National Transport Corporation	1.3
National Hotel Corporation	0.5

Source: Calculated from ZIMCO (Various issues)

As can be seen in Table 1, the largest share of all ZIMCO assets was occupied by MINDECO. This mirrored the centrality of copper mines to the Zambian economy. And this also implied that more than 75% of ZIMCO's assets were formed through takeovers, rather than through the creation of new enterprises (ZIMCO, various issues).

The Financial Performance of ZIMCO

The Zambian government's economic development objectives (of which high economic growth rate was central) were to be accomplished through SOEs (Republic of Zambia, 1971; 1979). Since ZIMCO was the holding corporation of all SOEs, this put its financial performance under the spotlight. The financial performance of the ZIMCO group of companies, as can be shown in Table 2 during the period of 1971 to 1989, with the State's economic dominance, had a direct bearing on economic growth rates.

Table 2. Profitability of ZIMCO from 1971 to 1989

Period	Average Profit Margin After Tax (in percentage)
1971-74	16.37
1975-78	2.83
1979-82	2.03
1983-86	-1.68
1987-89	2.1

Source: calculated from ZIMCO Annual reports (various issues); The Republic of Zambia (Report of the Auditor-General on the accounts of parastatal bodies, 1988).

As can be seen in Table 2, the financial performance of ZIMCO reflected copper mining business performance, since this was a dominant portfolio in the ZIMCO group of companies. ZIMCO recorded the highest profit of 16.37% during the 1971-74 periods. The high profits were driven by the booming world copper prices during that period. The profits made in the mining sector were re-invested in various non-mining sector SOEs.

However, this came to an end with the burst of the world copper-price bubble in the mid-1970s. This resulted in copper mines' profits being reduced to negative yields in the 1980s, which resulted in the Zambian economic crisis that followed (ZIMCO, 1990).

Public Investment in the 1990 to 2011 Period

The dissatisfaction with the public investment leadership economic model, following the 1980s ZIMCO financial losses obliged the State to revert to

the market-economy model. During the 1991 to 2000 privatisation programme, public investment was largely displaced by private investment. Growth in public investment was once again limited to core infrastructural provision that complemented any growth in the private investment.

This was the guiding economic philosophy in the growth of public investment, even during the privatisation exercise of the 2000 to 2011 period (Republic of Zambia, 2004; 2006).

Trends in Public Investment in Zambia from 1964 to 2011

The evolution of public investment in Zambia can be summarised by Figure 1, which shows its growth trend from 1964 to 2011. Although public investment was increasing from 1964, an accelerated increase was registered during the period 1967 to 1970 – the Mulungushi and Matero reform eras. With the sustenance of the high profits made in the copper-

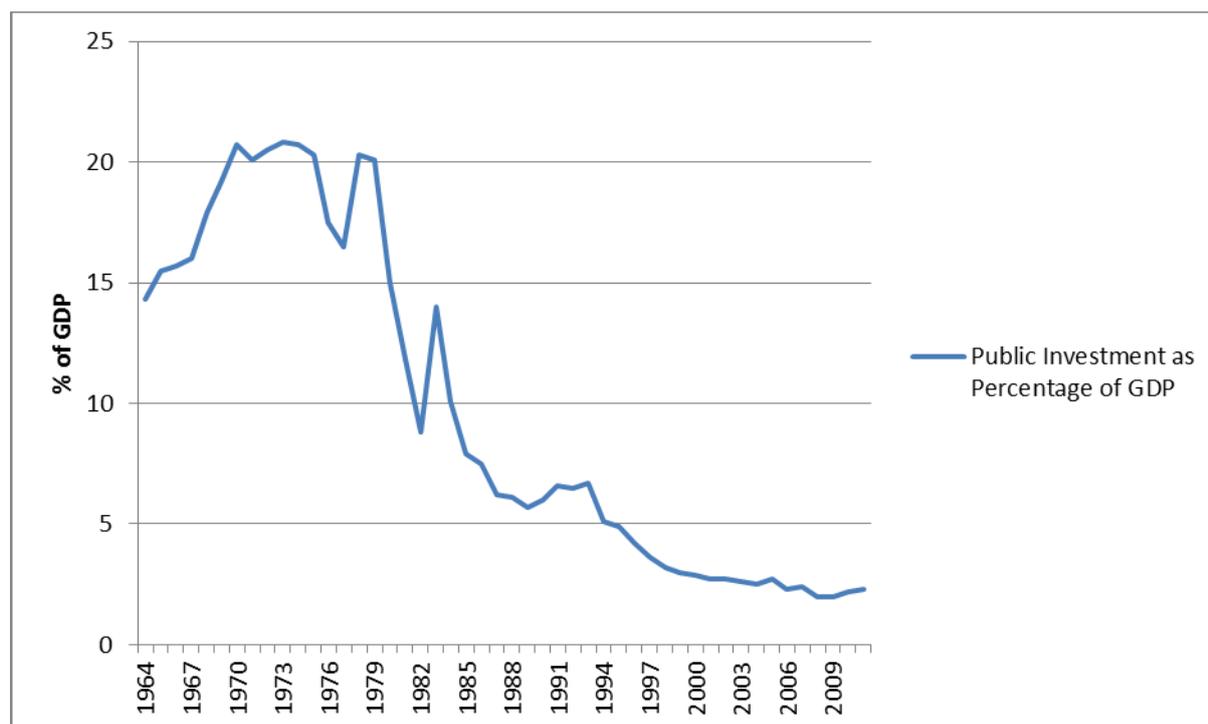
mining business, high public investments were maintained until the mid-1970s.

The fall in world copper prices in the mid-1970s undermined the ability of the copper-mining industry to sustain growth in public investment in other sectors of the economy. When the State realised that it could no longer sustain the growth in public investment with borrowed funds, it adopted the market reforms in the 1980s that resulted in a sharp drop in the growth of public investment in Zambia. The market

reforms were soon abandoned, reverting to the command economy in the mid-1980s, which once again resulted in the deficit-financed growth increase in public investment.

This growth was short-lived, however, as the State once again adopted the market reforms of the late 1980s, which set the stage for the more comprehensive privatisation pattern that followed (Craig, 1999; 2000).

Figure 1. Public Investment Growth as a Percentage of GDP from 1964 to 2011



Source: Central Statistical Office Data (Various Issues)

The Structural-Adjustment Programmes (SAPs), which were adopted by the Zambian government for the 1991 to 2000 period, were responsible for a further cut in public investment. The privatisation of the State enterprises, which was at the centre of the SAPs greatly reduced the growth in public sector investment. Its growth was limited to minimum levels: scarcely enough to provide the basic infrastructure needed to promote private-sector growth.

This was the guiding economic philosophy in public-sector investment in the period from the year 2000 to 2011.

Private Investment in Zambia

The evolution of private investment in Zambia can also be traced from its independence in 1964. At independence, the private sector was in a leadership position in all the economic activities. The new government perpetuated this economic dominance by

promoting the growth in new private enterprises through INDECO. Through INDECO, the Zambian government created a package of incentives to promote private-enterprise growth. For example, the tariff-protection incentive allowed tax exemption for up to five years for selected new industries; the relaxation of the repatriation of dividends, interest and capital; and a positive discrimination towards local indigenous producers in government tendering (Republic of Zambia, 1966b).

Although the adopted market economy produced impressive economic growth rates for the first three years after independence, this economic strategy was replaced by a command economy via the 1967 Mulungushi and 1968 Matero declarations (Kaunda, 1969). Through the State-directed acquisition of the existing private enterprises, the growth in private investment was outpaced by that of public investment. The growth in private investment remained suppressed for the greater part of the 1970s – the State’s period of economic dominance.

The situation changed, following the financial losses of the Zambian Industrial and Mining Corporation (ZIMCO), which were precipitated by the mid-1970s fall in world copper prices (Republic of Zambia, various).

Private investment again occupied a centre stage when the Zambian government re-considered adopting the market reforms following the 1970s parastatal losses. The 1978 adopted SAPs, which were backed by the International Monetary Fund (IMF), ushered in a new phase of private investment growth. Once again, there was a considerable effort to promote the growth in the private enterprises, while various cuts were made in public investment expenditure. The first SAP was soon followed by the second in 1983, which focused on more-sweeping parastatal reforms.

Among the second SAP package reforms, there was the removal of subsidies extended to SOEs, the liberalisation of interest rates and prices, and the reduction of tariffs, which were characteristic of the previous command economy (Bigsten and Mugerwa, 2000).

Although private investment growth accelerated with the adoption of a third dossier of the SAP package in the mid-1980s, this was short-lived, when the government abandoned it, and instead adopted the New Economic Recovery Programme (NERP) in 1987. NERP was premised on the command economy, which later on resulted in the deficit-financed growth in public investment. Like its predecessor policy, the NERP was short-lived, however, when the government at the end of the 1980s reverted to the market economy.

The change in the market forces in economic management set the stage for the greater privatisation exercise that was then to follow (World Bank, 1991).

Enhanced Privatisation of the State-Owned Enterprises: 1991-2000

The private sector growth was greatly enhanced from 1991, when the new Zambian government set out to implement a broader privatisation exercise under the IMF's SAPs than that which had been carried out by the previous government. The principal objectives of the 1991 to 2000 privatisation of the Zambian economy were to promote the growth of private enterprise, to accelerate economic efficiency, and to increase economic growth rates (Zambian Authorities *et al.*, 1999).

Thus, the new government resolved to implement the outright disposal of all State-owned enterprises, with the exception of public utilities and

other strategic industries to the economy (World Bank, 1991).

The guiding economic philosophy during the privatisation process was that the government would disengage from any commercial activity, and would concentrate its investment in the provision of basic infrastructure.

To oversee the privatisation programme, the Zambian Privatisation Authority (ZPA) was created, after the introduction of the July 1992 Privatisation Act. The duties of the ZPA included, among others: (i) Recommending to the cabinet on privatisation policy guidelines; (2) drawing up the privatisation schedule; (3) monitoring all steps in the implementation and progress of the privatisation exercise; (iv) recommending the long-term divestiture plan approved by cabinet; (v) recommending to the cabinet the method of sale of each SOE; (vi) setting the qualifying criteria for the selection of buyers of the SOEs to be privatised; (v2) assessing offers from potential investors on the criteria of price, the capability to develop enterprise and expertise; (v3) implementing measures to ensure that no monopolies were created during the course of the privatisation exercise; and (ix) the general administration of the privatisation exercise (Republic of Zambia, 1992).

The ZPA had a variety of methods at its disposal, as set out by the Privatisation Act of 1992, which it could choose and recommend to the cabinet for adoption. These included: Government-shareholding dilution; offering shares to the public; competitive bids or negotiated private sales; selling to management or employees of the SOEs to be privatised; assets and business selling of SOEs; lease and management agreements; and restructuring of the SOEs before the sale thereof (Republic of Zambia, 1992).

To proceed with the privatisation programme, the ZPA drew up a divestiture sequence plan that was to run for a period of five to ten years. The plan grouped all the SOEs to be privatised, except the Zambian Consolidated Copper Mines (ZCCM), in eleven tranches. The size and sector of origin were the criteria used to tranche the SOEs to be privatised. Small companies, which were easy to sell, were put in the first tranche; and these were to be used as a pilot test to the privatisation programme (ZPA, 1995, 1996, 1997 and 1998, a, b, c, d, e).

The rate of progress of SOEs' divestiture was initially slow after implementation. However, the pace increased from 1995, with the disposal of medium and large enterprises. Table 3 summarises the number of SOEs that were privatised from 1993 to 1999.

Table 3. Privatisation of SOEs by Quantity from 1993 to 1999

Year	Number of units sold
1993	4
1994	5
1995	52
1996	85
1997	58
1998	11
1999	5

Source: ZPA (Privatisation Status Report, 25 January 1995 and 30 April 1996; and summary Status Report, 1/1999a)

As may be seen in Table 3, most of the SOEs were privatised in the three years, 1995 to 1997; these comprised the years that had the highest number of units sold. The rate of divestiture slowed in 1999, with only 5 units sold. By the end of 1999, a total of 222 SOEs had been privatised; and this represented more than 80 per cent of all SOEs targeted for divestiture (ZPA, 1/1999a).

With regard to the privatisation of the ZCCM, the Zambian government was more cautious in its approach. This was principally because the copper mines were the springboard of the economy; and their

successful privatisation was crucial for the rejuvenation of the economy. This put the privatisation of the ZCCM under the spotlight – ahead of other SOEs (ZPA, 1995).

After extensive consultations, the assets of ZCCM were eventually privatised from 1996 – through the unbundling method (ZCCM Annual Report, 1996). As may be seen in Table 4, the assets of the ZCCM were unbundled into packages from ‘A’ to ‘I’ units. These were then sold to private buyers.

Table 4. Packages of the unbundled ZCCM

Package	Mine/Assets
A	Nchanga and Nkama Division
B	Luanshya Division
C	Mufulira Mine and Concentrator
D	Chambishi Mine
E	Kanshansi Mine
F	Nampundwe Pyrite Mine
G	Chambishi Cobalt Plant
H	Ndola Precious Metals Plant
I	Electricity Distribution Division

Source: ZPA (1996)

The first package to be successfully sold was ‘E’ in 1997. Other packages that followed had their disposal spanning the period 1997 to 1999. The rate of disposal was slow, however, mainly because of the depressed world copper prices, which rendered the assets of ZCCM unattractive at that time. Despite this situation, its disposal attracted mostly foreign investors with much-needed new capital and technology to resuscitate the copper-mining operations (ZPA, 1/1999a).

The major privatisation exercise came to an end with the conclusion of the divestiture of the ZCCM assets. This greatly transformed the Zambian economy to the private-sector-led model, which became more responsive to market forces than ever before. However, although the economic dominance of the parastatal sector came to end with the privatisation programme, the conditions that

guaranteed the full working of a free market system were still inadequate.

Inefficiencies after privatisation continued in the wake of the poor infrastructure, the lack of technology, information asymmetry, and few market players – among other obstacles. It was principally for these reasons that the Zambian government set out to establish conditions that would enable the full operation of a private sector-led economic model in the years that followed soon after the privatisation exercise (Republic of Zambia, 2004).

Private Investment Enhancement Policies in Zambia: 2000-2011

After the successful privatisation of the SOEs, the Zambian government embarked on policies to improve the general business and investment environment that had handicapped the full operation

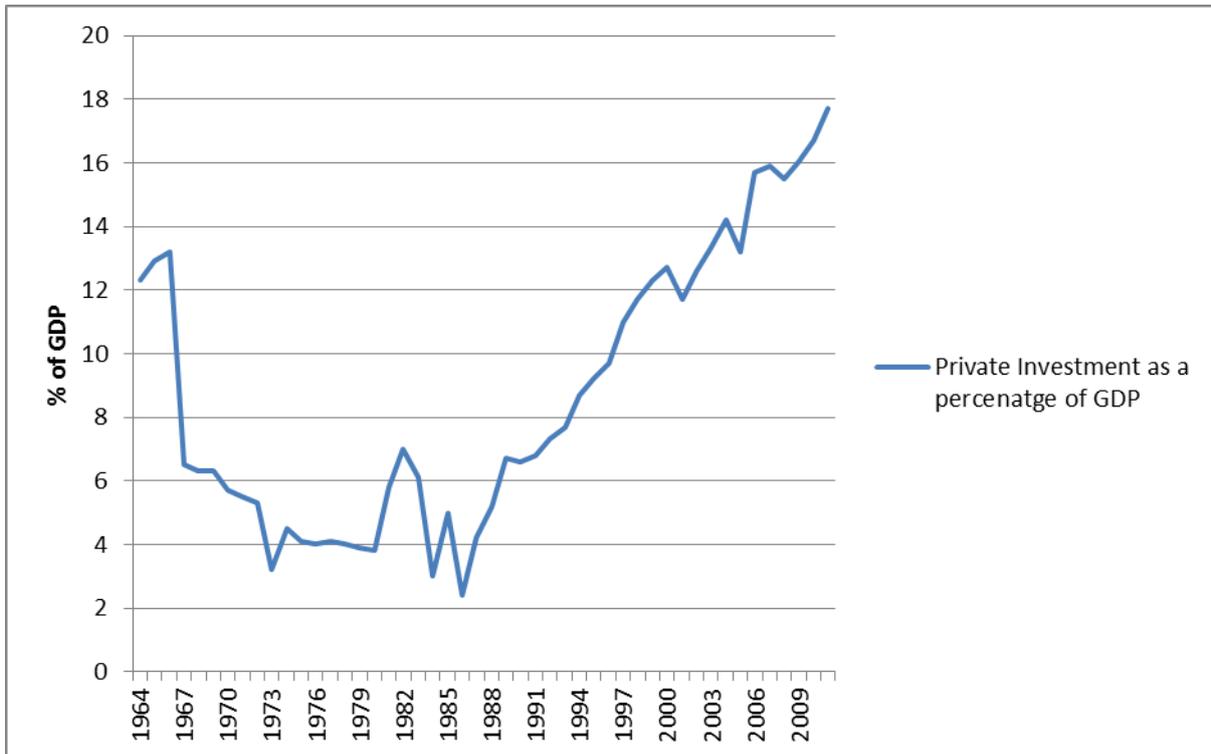
of the established private sector economic model. One of the key actions taken was to adopt and implement the Private Sector Development Reform Programme (PSDRP) in 2004, in order to accelerate private sector-led economic growth (Republic of Zambia, 2004).

The principal aim of the PSDRP was to establish a favourable and competitive climate that would enable the private enterprises to flourish. Its goal was to create an impetus for a faster sustainable economic growth, led by the private sector through establishing an ‘easy-to-do’ business environment in Zambia. It was anchored on six reform pillars, which were: (a) To improve the policy environment and institutions that serve the private sector; (b) to implement regulations and legal policies; (c) business facilitation and economic diversification; (d) trade expansion; (e) citizens’ economic empowerment; and (f) infrastructural development (The Republic of Zambia, 2006).

Trends in Private Investment 1964-2011

The overall growth trend of private investment in response to the economic policies implemented from 1964 to 2011 can be seen in Figure 2. For the first three years, after independence in 1964, private investment growth in Zambia increased in response to the extension of the adopted market economy. It then sharply declined to minimum levels from 1967, following the government’s economic nationalisation programme. During this period, public investment growth dominance overshadowed any growth in private investment – until the end of the 1980s. With the comprehensive privatisation programme undertaken in 1991, and the PSDRP of 2004, growth in private investment trended upwards, dominating the entire spectrum of economic activities.

Figure 2. Private Investment Trends from 1964 to 2011



Source: Central Statistical Office (Various Issues)

While Zambia has made good progress in improving the business environment, the full operation of the private sector economic model is still constrained by a number of challenges. These include: inadequate and poor infrastructure, the high cost of human capital, cumbersome administrative procedures, and the high cost of financial capital (The Republic of Zambia, 2011; UNCTAD, 2011).

Conclusion

The dynamics of public and private sector investment in Zambia from 1964 to 2011 have been the focus of discussion in this paper. It has highlighted the major policies, reforms and challenges that have shaped the two components of investment. Upon attaining independence in 1964, public investment growth was limited to basic infrastructural provision, adhering to the dictates of the adopted market economy. It,

however, grew to economic dominance in the 1970s, following the 1967 Mulungushi and 1968 Matero reforms. Initially, through INDECO, and later ZIMCO, State-owned enterprises grew to an extent that they overshadowed the growth in private investment. The falling world copper prices in the mid-1970s, and the resultant financial losses of ZIMCO, provided an impetus for the re-examination of the public investment economic strategy by the end of the 1980s. The 1991 to 2000 privatisation programme largely eliminated public investment, once again limiting its growth to economic activities that complemented private investment, such as those in the basic infrastructural provision. The basic infrastructure hypothesis became the guiding economic philosophy in public investment spending from 2000 to 2011.

Although the economic dominance of the private sector was perpetuated for the first three years after independence in Zambia, it was later displaced by the State-led economic strategy, following the Mulungushi and Matero economic nationalisation programmes. The State-led economic model until the late 1980s choked the growth in private investment, mainly via two ways. Firstly, the State, in most situations, produced products that were in direct competition with those of the private sector. Secondly, the growth in public investment was mostly deficit-financed; and that increased interest rates higher than could be afforded by the private sector. However, the shift to the market economy through the IMF-backed 1991 to 2000 privatisation programme that was undertaken, and the PSDRP (2004), once again put the private sector in the forefront, as the leading engine of economic growth. This paper has observed that, although private investment has grown to be at the centre of all economic activities in Zambia, like many developing countries, the country still faces a number of challenges that affect its growth potential. Inadequate and poor infrastructure, the high cost of human capital, cumbersome administrative procedures, and the high cost of financial capital, are some of the major challenges facing private investment growth in Zambia (see The Republic of Zambia, 2011; UNCTAD, 2011).

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