Policies and realities

the state of privatisation

If the South African government wants to serve the poor, then privatisation is not appropriate, argues Neva Makgetla.

In July, COSATU declared a Nedlac section 77 dispute with government over privatisation. The dispute relates, not to privatisation in the narrow sense of selling state assets, but rather broadly to the replacement of state functions with the market or private control.

This article first reviews the grounds for the section 77 dispute. It then outlines some government policies on privatisation. The third section gives an analysis of why privatisation is not appropriate in South Africa – the main problem being that it is inherently difficult, if not impossible, to force the private sector to serve the poor or become involved in restructuring the economy. The final part of the article gives examples of the damage already caused or likely to occur from current privatisation practices.

Defining privatisation

COSATU's section 77 notice defines privatisation in terms of the extension of the private sectors' control and wealth at the cost of the state. These processes include:

- the sale or partial sale of state assets or state-owned enterprises (SOEs);
- the introduction of private competitors in sectors traditionally controlled by the state;
- relinquishing the management of state functions to the private sector; and
- requiring government agencies to operate on a commercial basis. Commercialisation is often a first step toward privatisation and subjects state activities to the logic of the market.

Through this definition, COSATU demands, not just an end to the sale of SOEs, but the re-examination of whether it is desirable for market forces to govern the delivery of basic services.

Government policy

In public, government generally argues that it will not privatise on a wholesale basis. Government documents use less controversial terms such as 'restructuring' or 'public-private partnerships'. Yet key policy documents point to an overwhelming belief in the effectiveness of markets and private managers. These documents regard privatisation as a way to compensate for recent budget cuts. However, they fail to propose strong regulatory structures or analyse the costs and benefits of privatisation.

The treasury has adopted a particularly

uncritical approach to privatisation. In the Budget Review 2001, it argues that restructuring of SOEs can 'broaden economic participation, recapitalise public enterprises and reduce state debt'. The treasury supports privatisation as it can raise funds to stick to Gear targets. In 2001/2, it expects privatisation of the major parastatals alone to raise R18-billion. This is 7,4% of the budget.

The Department of Public Enterprises' (DPE) 2000 policy framework effectively commits government to bringing in private interests wherever possible. It believes that full or partial privatisation can enhance the productivity and profitability of SOEs by giving it access to additional funding, technology or markets.

The DPE argues that competition will improve services for all. So, it pushes for private competition in state-owned industries such as rail and electricity. The Department of Trade and Industry agrees that it is important to introduce competition into sectors traditionally controlled by the state.

The Municipal Systems Act is the only legislation on restructuring the state. It applies only to local government. The Act sets limits on privatisation very similar to those COSATU demands in its section 77 notice. Unfortunately, faced with the national government's pressure to privatise, municipalities have largely disregarded the Act.

Government's overwhelming support for privatisation contradicts the ANC's historically more cautious view. In 1992, 'Ready to Govern' committed the ANC to restructure the public sector based on evidence about developmental needs. It argued that shrinking or expanding state control should depend on whether it will 'strengthen the ability of the economy to respond to massive inequalities, relieve the hardship of the majority of the people, and stimulate economic growth and competitiveness'.

The Reconstruction and Development Programme (RDP) and the 1997 Mafikeng Conference argued for a strong state. In its 1999 and 2000 election manifestos, the ANC made no reference to privatisation. It stressed the importance of an active public sector. The 2000 manifesto committed government to:

- keep the public sector as the preferred provider of municipal services, to ensure adequate service for all communities;
- ensure local government has the powers and resources to serve the communities adequately using a system of subsidies to local government.

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Shortcomings of privatisation

Overall, government policies praise market forces while calling vaguely for regulation. Ultimately, these policies make three key assumptions:

- Competition will lead to lower costs and better quality services for all consumers.
- Regulation can control any negative effects.
- Privatisation will bring additional resources at no cost to the state or consumers.

This article will now discuss these assumptions.

Are SA markets efficient?

The first assumption supposes that South

African markets are socially efficient.This assumption holds neither in theory nor in practice. Because of very unequal incomes, private providers have little incentive to serve the poor or contribute to development.

Economic theory argues that markets will only be socially efficient if, amongst others, they have:

- sufficiently equal incomes;
- prices that reflect the full costs and benefits of goods and services to society;
- resources that move easily between activities.

South African markets meet none of these conditions.

We inherited a particularly unequal distribution of income. Estimates suggest that South Africa ranks third worst in the world.

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Massive income inequalities mean the market will not bring about long-run development. In effect, poverty in itself creates poverty, by lowering productivity and employment.The market cannot break this vicious cycle, since the poor majority cannot afford to pay the full cost of basic services. In these circumstances, private business cannot capture the full social benefits of providing services to the poor.

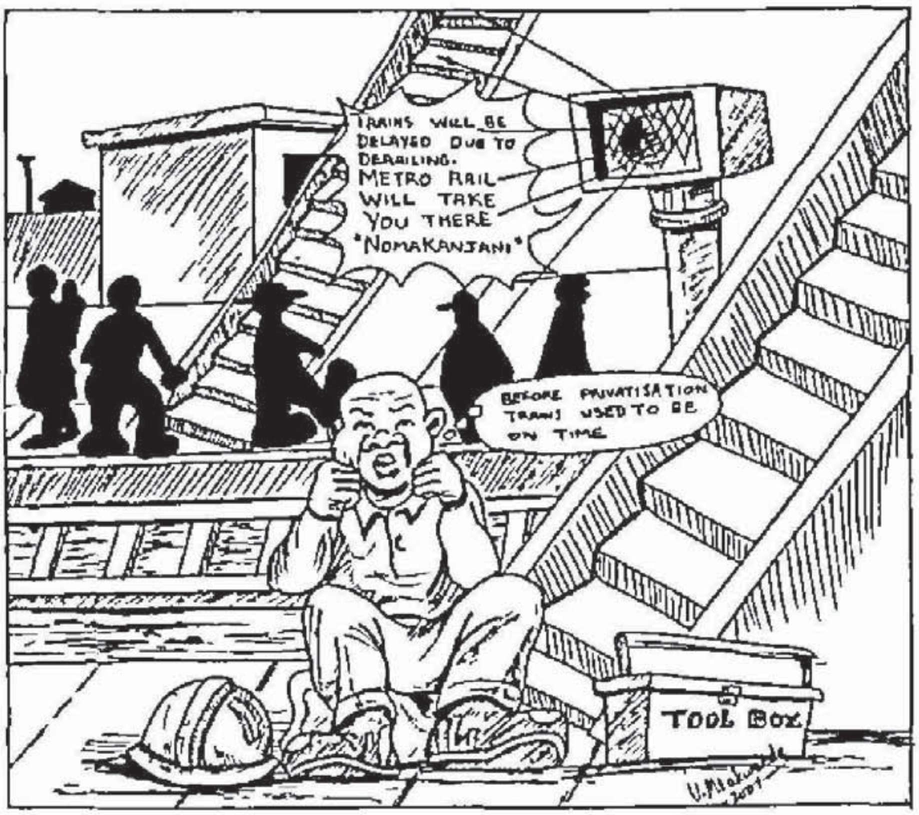
As a result, privatisation cannot contribute to the growth of home-based micro enterprise, particularly in rural areas. Privatised industries would rather serve large enterprises, which can buy in bulk and pay higher tariffs.These privatised industries avoid the difficult and expensive task of extending infrastructure to households.

The DPE's policy framework argues that despite these shortcomings, as consumers exercise their market choices, the market will bring about efficiency.This will happen because 'consumers may be prepared to accept a lower quality of service in exchange for a reduced price'. One wonders where the authors live. Few South Africans have the luxury of making choices about basic services.They must get them from the state or not at all.

Privatisation just to introduce competition may undermine industrial strategy. Often, restructuring the economy and competing internationally requires large-scale enterprises. In contrast, for both Eskom and Spoornet, the push has been to fragment large and powerful entities into many small companies.

Privatisation often leads to mass retrenchments as private managers close down less profitable operations.Where companies plan to list shares on the stock exchange through an initial public offering (IPO), they want to look lean with lots of cash. So they subcontract or downsize. Thus,Telkom has lost over 15 000 jobs in the past three years.

The DPE argues that more efficient companies will lead to economic expansion, creating new jobs for the displaced workers. But unemployment is now officially over 20%, and the formal sector loses thousands of jobs every year. The majority of the workers retrenched by privatised industries are less skilled, and many live in rural areas where



Cartoon: Vusumuzi Mtakwende

unemployment is highest. In these circumstances, they cannot expect to find new employment.

Regulation will not work

Because the developmental inefficiency of South African markets is undeniable, most government policies on privatisation admit the need for regulation. But closer examination demonstrates a lack of seriousness.

Effective regulation requires appropriate targets, monitoring and feedback mechanisms, and capacity to enforce regulations. South Africa has inadequate capacity in all these areas. Most policies on privatisation are not linked to targets for service delivery, or the targets are inadequate and poorly publicised. Also, the new regulatory agencies at national and local level do not have capacity to monitor privatised agencies consistently.

The adoption of policies that effectively require wholesale privatisation, as opposed to the case-by-case approach of the RDP, has led to a number of basic management mistakes. We need only mention South African Airways (SAA), Telkom and the Postbank. All of these brought in foreign managers and found themselves flooded with high-priced foreign employees and consultants.

Fiscal policy

Finally, we need to examine the assumption that privatisation will make up for under-budgeting.

Private investors do impose a cost on the state or consumers. To serve those who cannot pay, these investors will require a subsidy. For the rest, it must have tariffs that ensure at least a normal rate of return. In contrast, a state-owned service provider can decide on a lower mark-up or cross subsidisation to realise social and economic benefits.

If private capital were inherently more efficient than the public sector, it could still cut costs to the state. But almost no evidence exists that private managers are more skilled than public-service ones. Indeed, the experience with SAA and Telkom suggests the opposite.

A second fiscal motive for privatisation lies in the desire to reduce the public debt. In itself, this approach cannot justify privatisation of any single asset. An excessive focus on the immediate returns from privatisation will lead to shortsighted and costly sales of SOEs.

The real problem lies in an excessively restrictive fiscal policy. This is expressed through the attempts to cut local government budgets and parastatal borrowing, as well as tight targets for the national budget.

The arguments for privatisation are deeply flawed. They essentially start by assuming the efficiency of markets and private managers. Local realities have shown that this assumption is not true. These arguments also show an unjustifiable belief in government's ability to regulate private interests.

Ultimately, it is clear that fiscal policy is a primary driver of privatisation. Yet if market forces are not efficient, privatisation will not reduce the costs to society. Privatisation merely removes the cost from the budget.

Examples of privatisation

The following section documents some experiences with privatisation of rail freight, electricity, telecommunications and water.

Rail freight

Spoornet is the freight and long-distance passenger rail division of Transnet. Government announced its intention to concession two lines – Coallink and Orex. These two lines provide most of Spoornet's profits by transporting coal and iron ore. That would have left the General Freight Business (GFB) running at a loss. However, GFB plays a developmental role by providing a relatively cheap form of transport, and by reaching remote rural areas.

SATAWU argued that Coallink and Orex should be retained in an integrated, state-owned Spoornet. For one thing, the two lines made Spoornet as a whole financially viable. Internationally, most rail freight operations have some type of cross-financing between lines. In contrast, the state's proposals fell into the classic mould of selling off the most profitable activities while retaining social responsibilities – and costs – in government hands.

Ultimately, a joint labour-government task team embarked on a detailed financial analysis of the proposals. The task team has not yet finalised its recommendations. Yet, it became clear that in the longer run, it would cost the government money to concession the two lines – both for the profits of the private company, and to support the GFB. Moreover, Spoornet would lose up to 30 000 jobs.

It is indicative of the shortcomings of the push for privatisation that basic economic research into the concessioning was not completed until labour insisted.

Electricity

The current proposals for restructuring the electricity industry are peculiar. These proposals meddle with the parts of the sector that work well by international standards, while leaving fundamental problems unsolved. The results could be soaring costs for households, a slowdown in electrification, and may undermine investment in the industry.

No one denies that South African electricity is amongst the cheapest in the world. But many local governments, especially in the former homelands, cannot afford to maintain, much less extend, electricity systems. Moreover, around 2010 South Africa will need new generating capacity as demand exceeds current supply.

Government's response to these problems seems driven largely by the blind commitment to free markets described earlier. Government's proposals will:

- consolidate local-government systems into six Regional Electricity Distributors (REDs), which would compete to buy electricity from generators;
- permit private generation of up to 30% of electricity;

- separate Eskom into competing groups of power plants;
- move toward market prices for electricity, while maintaining cross-subsidisation of poor households by rich ones.

The shortcomings of these restructuring proposals reflect the broader imperfections of South African markets.

First, in distribution, the establishment of REDs ignores the huge inequalities left by apartheid. If REDs have to compete for skills and funding as well as wholesale electricity, there is little doubt that the poorer provinces will come off worst. The government has agreed to a national holding company to support the weaker REDs for at least six years. Still, it is not clear if this national holding company can counteract the negative effects of regional competition.

Within regions, if REDs have to maximise profits, only regulation can force them to maintain services to the poor. Establishing a regulatory framework able to monitor services and set appropriate targets will certainly cost more.

Second, in supply, government has not been able to give COSATU any evidence that private generation is either necessary or likely to be cheaper than Eskom production. As far as COSATU can tell, no serious study has been done to back up this assumption. The risk is that, without detailed investigation, South Africa could licence private producers and down the line face demands for tariff increases.

Third, the proposed tariff system would end the cross-subsidisation of households by industry. This would result in increases of between 20 and 50% in the cost of electricity to households. This proposal is already being implemented under the name of the Wholesale Electricity Pricing System (WEPS).

In this context, it is worth noting that the international experience of privatising electricity has often been disastrous. A study by the Public Services International Research Unit (PSIRU) gives examples from, amongst others, New Zealand, Australia, the United States (US), the United Kingdom, Argentina, Brazil, the Dominican Republic, Moldova and Kazakhstan. For example:

- New Zealand had two months of power cuts in 1999 because the private electricity company did not maintain the underground cables.
- In California, the privatisation of electricity led to a 300% price increase and frequent power failures. As a result, the state's total production dropped by 10% in 2000.

Telecommunications

Privatisation has affected telecommunications in two ways: the sale of 30% of Telkom to US and Malaysian investors, with a further 20% planned for an IPO; and the liberalisation of the telecommunications market, initially to cellphone operators and more recently to a fixed-line competitor and the Internet. Again, a naïve belief in the efficiency of private companies and the market appears to drive these policies.

International experience shows that introducing competition increases costs for the poor, lowers costs for business and the rich, and means relatively slow improvement in access. In the past three years, the price of local calls, which the poor use more, increased in real terms by around 35%. In addition, basic rental costs are high. In contrast, the price of domestic long-distance and international calls dropped.

Rising costs for local calls and basic rentals have pushed telephones beyond the reach of most South Africans. Many connections are terminated every year, largely because users cannot pay. Thus, in the year to March 2001, Telkom provided 620 000 new connections while 220 000 lines were terminated.

The regulatory framework seems unlikely to ensure affordable universal access. It does not set any time frames, and considers households to have access if they are less than half an hour away from a telephone. The latest policy directions give only the vaguest guidelines on universal and affordable access.

Telkom itself has been commercialised and partially privatised. The foreign partners only have a minority share in the company. Yet, it has become clear that on key issues – including investment and employment – they have effective veto power.

As noted above, the company has also lost thousands of jobs. Downsizing seems largely an attempt to slim the company down for its IPO. In the past three years, Telkom has lost around a third of its labour force. The retrenched have mostly been unskilled African workers, many in rural areas where no other job opportunities exist. With unemployment already at record levels by world standards, the IPO is being bought at a high cost.

In short, privatisation in telecommunications has followed the classic path: worse services for the poor, high job losses, and improvements only for formal business and the rich. For this reason, COSATU argues that new competition should be allowed only at the top end of the market, where the market would function efficiently to provide better services. The state, through Telkom, must take direct responsibility for achieving universal and affordable access.

Water

Water supply is one of the main areas facing privatisation at local government level. Examples from developing countries, including South Africa, show that water privatisation leads to higher prices and worse services, while the state still provides the investment finance.

South Africa faces particular challenges around water. Water provision in South Africa lags behind many middle-income developing countries. About 86% of South Africans have access to improved water, compared to 95% or more in Uruguay, Costa Rica and Malaysia.

Government policies generally say that regulations and contracts will compel private owners to meet social needs. Almost invariably, however, in the Third World private service providers renegotiate the developmental requirements after a year or two of their contracts.

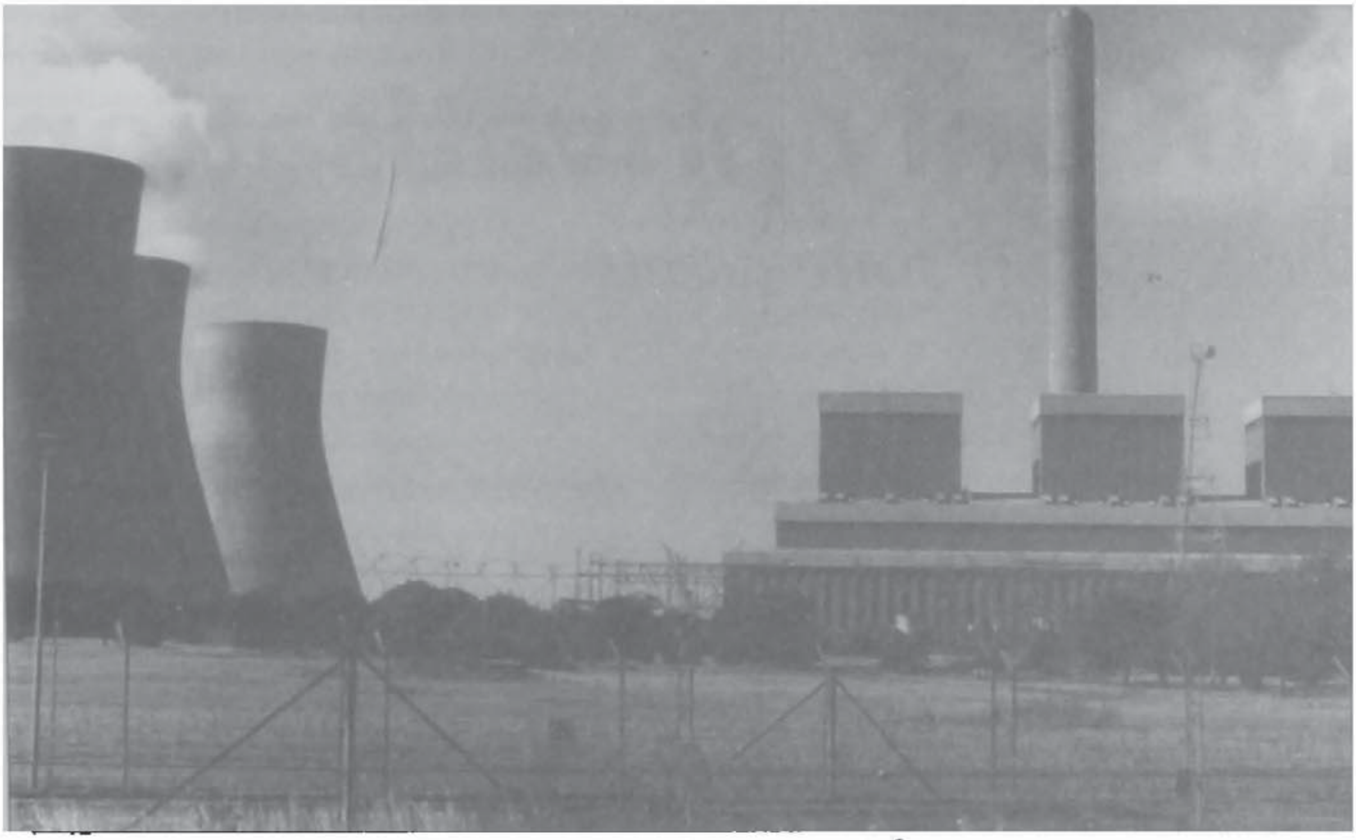
This is exactly what has happened in the Dolphin Coast in KwaZulu-Natal. The municipality signed a contract with a foreign-owned water company, Siza, in 1999. Just a year later, Siza demanded renegotiation. It argued that it had a R12-million shortfall because demand for water was lower than expected. The contract provided for renegotiations if returns were above or below the expected rate.

Specifically, the renegotiations provided:

- a 15% increase in the tariffs;
- measures to reduce costs, including possible cuts in the concession fee paid by Siza to the municipality – which would also cut funding for the regulatory agency;
- Siza's five-year investment will drop to R10-million from R25-million.

Clearly the company's need to maintain a particular rate of return has become the main consideration. Equity, meeting needs and ensuring access for all have taken a back seat.

Problems have also been experienced



Government's proposals will separate Eskom into competing groups of power plants.

with the privatisation of water in Nelspruit. Its municipality signed a 30-year contract with Biwater. Since then, there has been little progress in meeting contractual obligations. Residents complain about high and confused billing, disconnections and leaks. It also turned out that Biwater did not have the funds to meet its promises on investment. Eventually, it fell back on the public sector. In November 2000, the Development Bank of South Africa announced it would loan R150-million to Biwater to carry out the investment programme.

All in all, both practical and theoretical analyses demonstrate the shortcomings of privatisation. COSATU hopes that its actions in the next few months will ensure that South Africa adopts more sensible policies in the future. ★

Notes

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