The new privatisation debate

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In this extract from her recent research paper, NEVA SEIDMAN MAKGETLA examines the reasons given for wholesale privatisation in the public sector. She finds them unconvincing and proposes more emphasis on democratic control and stakeholder linkages rather than privatisation.

ON 29 October 1994, the Cabinet announced a six point plan to transform the public sector. It included the possibility of privatisation of government assets, ranging from surplus cars, other equipment and buildings, to major parastatals like Transnet and Eskom. These privatisations would have the goals of raising funds and empowering black people.

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Spokespeople for local and foreign business interests welcomed the possibility of privatisation. Above all, they wanted the government to sell the major parastatals.

This article examines the existing process of preparing for privatisation and the various arguments for privatising the major parastatals. It focuses on the utilities, which provide basic services such as electricity, transport and telecommunications, and the Industrial Development Corporation (IDC).

▲ Will privatisation extend services to the majority?

The nature of privatisation

Government assets take different forms, and the implications of privatisation differ in each case. We can define three broad categories of privatisation:

- the transfer of fixed assets, divorced from their organisation, as when the South African National Defence Force (SANDF) sells obsolete equipment;
- the sub-contracting of functions alone, for instance when municipalities contract with a private agency for rubbish disposal; and
- the sale or transfer of organisations with their assets, as with Iscor or the Model C schools.

This article focuses on proposals to shift major parastatals into private hands, usually by selling them. The effects depend on the impact on decision-making about how to use resources. By changing ownership, it effectively changes who has final control over how the assets are used.

The sale of organisations seems the most difficult to assess. In effect, it shifts ownership from the public to the private sector. But ownership does not, of itself, guarantee control over all aspects of operations. Decisions about the disposal of profits, investment and production rest with different groups in different companies.

In the parastatals, management retains control over most operational decisions, while shareholders and creditors get a share of the surplus. The commercialisation process explicitly sought to divorce the government, as shareholder, from control over operations. Government decided that parastatals would concentrate on profit-making. Management would be freed from government interference in operations.

Still, many parastatal managers (for example, in Eskom and the IDC) continued to act according to their perceptions of the national interest rather than strictly to maximise profits. The corporate culture remained one of public service.

Privatisation changes who has final control over assets and over operational decisions — especially investment and employment. Ultimately, selling stock to private interests puts the need to make profits first. It makes other explicit or implicit goals less important. Since corporations must compete for investment capital, they have to find ways to increase their profits. Profit rates can fall as a result of cross-subsidisation (ie charging some consumers — the rich — more, and all other consumers — the poor — less). Moreover, privatisation can reduce the capacity of users to exert political control over service-providers, for instance through forums.

Commercialisation made profit maximisation the main goal in theory, but often not in practice. Privatisation will compel parastatal management to concentrate solely on profit maximisation.

Four reasons to privatise (maybe)

We here seek to unbundle the four reasons usually given for privatisation.

Relieving fiscal pressure

The commitment to strong fiscal discipline foresees cuts in government spending in real terms, a shift from current to capital spending, and the movement of resources into the RDP fund. Thanks to a combination of policy decisions and actual constraints on spending, the government is caught in a fiscal vice.

At first glance, privatisation seems a way out of this dilemma. It would increase government revenue without raising taxes or borrowing. Minister Liebenberg has committed the state to using the money only to reduce debt.

But the revenues that would result from selling parastatals, even at the full value of their assets, seem relatively low. If we exclude the main

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enterprises, the potential returns are far too small to make a big dent in national commitments. Moreover, the companies may not get full book value, as their profit rates remain relatively low. Estimates of Telkom s sale value thus range from R2billion to R9billion depending on assumptions about future profitability and debts.

The Office for Public Enterprises estimates the gross assets of the major parastatals (Eskom, Transnet, Denel, Alexcor, Safcor, Sun Air, Transkei Airways and Aventura) at R100billion. Telkom's gross assets come to around R14billion. But altogether, the companies owe over R80billion. Based on these estimates, the government could earn around R25billion from their sale.

How much is R25billion? Obviously, the sum is not trivial — but it would not come close to providing durable fiscal relief. It would pay for around a year's interest on the national debt. If invested at commercial rates, it would earn around R3billion per year, under 2,5% of the national budget. It would permit more than a doubling of state spending on housing. But the SANDF alone absorbs more than four times those returns. It would cost more than R6billion to equalise state spending for one year on black and white school children.

The potential for fiscal relief virtually disappears if we exclude the major utilities and Denel, the arms manufacturer. The government did not give an estimate for the value of state forests. The total assets of Sun Air, Transkei Airways, Alexcor and Aventura come to around R400million. Even before subtracting debts, the amount would pay for the school feeding scheme for one year.

But even this may be optimistic: the business press suggests that the low profitability and high debts of the largest state companies mean they are worth less than the book value of their assets. Private purchasers may want the government to take over their debts before privatisation. The costs run into billions of rands — perhaps R6billion for Transnet alone.

In short, in contrast to the sanguine views of the business press and some politicians, privatisation of parastatals promises only slight relief for the fiscus. It could provide only limited help for a year or two.

More effective than privatisation are deep-seated changes in expenditure patterns. The danger is that bureaucrats and big business will push for privatisation precisely to avoid cuts in government spending on the privileged minority.

Encouraging efficiency

Supporters of privatisation argue that it will enhance efficiency because, to maximise profits, companies will strive to produce what consumers want and to cut costs. The problem comes when profit maximisation by the individual firm imposes costs on society.

In this section we examine three aspects of efficiency.

Efficiency: contributing to reconstruction and development

Privatisation of utilities seems likely to prevent the extension of services to the poor majority and economic restructuring on the scale envisaged in the RDP — unless the government provides substantial subsidies. In this case, the question becomes whether subsidising private companies or continued public ownership will prove cheaper and more effective in meeting national goals.

The government could try to use regulation of various sorts to compel parastatals to serve the poor/or invest in projects to restructure the economy. The effect would depend on the parastatals' underlying profitability.

In South Africa, the parastatals show little evidence of monopoly profits, so stringent regulations seem unlikely to work without subsidies. Their rates of return on capital is about 1,3% — well below private sector returns. More is paid in the form of debt servicing than in surpluses to the state.

To a large extent the parastatals' low returns on capital reflect the state's decisions to take up nationally important but unprofitable activities. Eskom illustrates the problem.

Currently Eskom earns around 12,5% on capital, but pays no tax. Its returns on assets come to under 10% — well below private returns. But increases in electricity prices have consistently been below the inflation rate. Profits have been reduced to subsidise all electricity consumers, including business.

If privatised, Eskom would have to earn much higher profits. It probably cannot cut unit costs enough to raise profits to normal rates. Instead, it would have to reduce its provision of services to poor communities, which cannot pay the full cost of connections. Or it would need to get government assistance.

In short, privatisation would change how society meets the cost of extending services to the poor. Instead of parastatals charging the rich more or reducing their own profits, the costs would have to be paid out by taxpayers as subsidies, or the poor themselves — if they can.

Employment and Investment

Privatisation may encourage management to cut costs by cutting jobs and investment, with very negative macro-economic implications. The revenues obtained from privatisation could then go to overcome the negative impact.

If the commercialisation programme of the past ten years indicates the impact of privatisation, the results seem discouraging:

1. the decline in investment by state enterprises accounted for virtually the entire decline in investment in the 1980s and early 1990s. Falling parastatal investment contributed substantially to the severe recession of 1989-93. After 1985, commercialisation, combined with the debt standstill and capital outflow, resulted in a major public investment slowdown with no equivalent pickup in private investment;
2. parastatal employment plummeted over the same period, aggravating the recession. Transnet, Telkom, the Post Office and Eskom accounted for 20% of net job loss in the period 1988-93 but only account for 5% of national employment.

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Unless internal restructuring takes place, with strong regulation, privatising the parastatals may simply replicate the conservative behaviour of the conglomerates. The private sector has been criticised for equating efficiency with production for the high income group and exports, while at the same time shedding jobs and cutting investment.

Efficiency: government administrative capacity

South Africa faces a paradox common to many developing economies. Given capacity constraints, no one doubts that government should limit its activities as much as possible. But the need for reconstruction and development means government must nonetheless take strong actions.

In these circumstances, the government can afford direct control only when necessary to achieve its aims. It should seek to develop structures and regulations to ensure autonomous agencies, whether private or not, act in accordance with policy. For instance, if the government turns housing development over to a community its administrative burden is reduced but accountability mechanisms must ensure the project produces. Similarly, if it can structure a network of institutional systems and regulations that will guarantee Eskom continues with electrification whether or not it is privatised, then it should privatise Eskom.

Mechanisms to that end include the development of detailed business plans to achieve key targets, with monitoring by stakeholders as well as state agencies; carefully targeted subsidies; and assistance with project design.

Naturally, the government would also need to ensure that it had sufficient capacity to ensure that private managers were not cooking the books. The US experience with regulation of private electricity producers is that the regulatory agency needs to shadow the private managers. This may mean that two management structures are established instead of one.

Given the distortions in markets and massive income inequalities in South Africa, it seems difficult or impossible to devise fully autonomous, privately managed systems for the major parastatals that will ensure they meet national goals.

Some state resources, however, shored up apartheid — military and security equipment, Mossgas and luxury cars for senior public servants. Other assets serviced only a minority or lie far outside the core functions of the state, as with the Aventura resorts. There seems little reason to keep these in state hands.

Democratisation of the economy

To analyse the effects of privatisation on economic power requires a distinction between profits and operational control. Modern company law functions to separate legal ownership and access to profits from day-to-day management.

While employee, consumer or community share-ownership schemes may let some people get profits from the parastatals, they leave decision-making power in the hands of company managers, investment funds and stock brokers. Indeed, as they reduce state influence they enhance management's control. In much of Eastern Europe and the UK the poor soon sold their shares to richer compatriots. The process then actually further concentrated ownership in the hands of a wealthy few.

In South Africa the proposal to use privatisation to broaden ownership has met with opposition from sections of government and business. Opponents argue that it will reduce the amount government earns. By definition, few of the disadvantaged can pay large sums for shares. Moreover, divided shareholders cannot easily attract new partners. For these reasons, *Business Day* argues that the state should favour small black business only when selling property, not equity in airlines or utilities. Other commentators would prefer to use privatisation to attract foreign investors.

Telkom — candidate for privatisation

Some politicians argue that shares should not go to individuals, but to major organisations in civil society, including trade unions. This proposal could give unions greater say in management — but could also lead to severe conflicts of interest with employees and communities. Transnet and Telkom alone have 150 000 workers. If their unions owned shares, they would have to help decide how to allocate company revenue between wages, consumers and their own dividends.

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Bringing in foreign investment

Some authorities — reportedly including the Minister for Finance — would use privatisation to attract foreign investment, rather than to distribute income more equally throughout the population. Selling major state assets could attract direct foreign investment by multinational corporations. Foreign merchant banks claim it would also boost South Africa's international credit rating.

However, the parastatals already mobilise substantial foreign funds through the sale of bonds overseas. In the early 1990s, the parastatals' foreign debts accounted for about one tenth of their working assets, some R17billion.

Privatisation, then, would probably replace foreign borrowing with direct investment. We thus have to investigate the relative costs and benefits of foreign investment compared to borrowing by local management. Some of the potential costs include lessened sensitivity to local social problems and policies, and to new domestic investment opportunities; an even higher outflow of surpluses if the foreign partner decides to invest in them locally; and, if the purchaser is also an equipment manufacturer, weakening in domestic technological capacity.

The argument that South Africa needs to boost its credit rating seems unconvincing. True, South Africa's current international credit ratings are low, which leads to high interest rates for international loans. But because of sanctions, overall foreign debt is very low by developing world standards. Relative to the Gross Domestic Product (GDP) and foreign-exchange earnings, South African debt is about half the norm for other countries at similar stages of development. In these circumstances, borrowing should not prove very difficult in the medium term, especially if social and political stability persists.

The argument that privatisation will attract foreign investment both directly and indirectly hinges on the belief that the benefits of direct for-

Anti-privatisation march, Johannesburg, 1990

eign investment outweigh the loss of state control over major parastatals. In other words, it depends on the belief that direct foreign investment brings net benefits. But selling core industries to overseas interests seems a risky course of action.

The way forward

Whether privatised or not, parastatals must re-examine and restructure their operations to meet the needs of the majority. To achieve that end will likely require that the government initiate substantial changes in the structure of parastatal management, and demand clear performance targets as well as plans to reach them.

There are six important implications for the process of restructuring the parastatals:

1. Fiscal policy must not drive the process. The parastatals are far too important for meeting basic needs, as well as maintaining employment and investment, to treat them simply as sources of ready cash. Cutting expenditure on inappropriate programmes is the only way to relieve fiscal pressure in the long run.
2. As far as possible, management in both the private and public sectors must avoid cuts in jobs or services to the poor in the name of efficiency. Instead the parastatals should seek to redeploy workers and investment to meet both the backlog of demand for basic services and the increased demand arising out of shifts in income, the Budget and government policy.
3. Stakeholder forums should have structured links to parastatal management. That is, forums of users and others directly affected by parastatal activities should have defined roles in decision-making around the parastatals. In the US, for example, representative advisory bodies have considerable regulatory influence. The parastatals themselves could help fund these processes.
4. Parastatal performance must undergo a regular assessment in terms of all their goals, not only in terms of financial soundness. For instance, even the current law can require the parastatals to report annually to Parliament on both their efficiency and effectiveness.
5. Currently, officials and consultants in the Office for Public Enterprises and Privatisation exert tremendous influence on privatisation decisions. They have undergone virtually no change in mission or personnel — even though the consultants who staff the Policy Unit do not enjoy Constitutional protection. This office must be completely overhauled or excluded entirely from the restructuring process. NEDLAC, individual Ministries or sectoral forums seem more appropriate managers of the restructuring process.
6. Research into the potential uses of government assets must not fall to the inherited bureaucracy and consultants, but to experts drawn primarily from the democratic movement. For instance, the government could allocate funds to NEDLAC to commission appropriate analyses. Under no circumstances should research rely on consultants or information from merchant banks who hope to earn fees from the sale of parastatals. ☆