

## **It's about ownership, not assets**

National and Labour are to be commended in this election campaign for proposing to sell shares in SOEs and to raise the age of entitlement for New Zealand Superannuation respectively. Both proposals have a clear national interest rationale, but took political courage.

Professor Tim Hazledine recently argued in the *New Zealand Herald* that it was rational for the public to oppose a partial sell-down of the Crown's ownership of SOEs because they "truly merit the designation of being 'strategic' businesses for our country". The claim is vague. Why is an electricity generator any more of a "strategic" business than are our banks, freight forwarding firms, Fonterra, or a major tourism business? And, if a hydro-electric power station is a "strategic" business under 100 per cent government ownership, why is it any less so with 51 per cent government ownership?

Professor Hazledine was clearly right, however, to object to earmarking the proceeds from a partial sale for particular spending projects. Those projects should stand or fall on their own merits.

He also avoided citing the spurious argument that partial asset sales would mean forgoing a dividend of higher value than the saving in interest on debt that could be repaid with the proceeds.

Rod Oram, a former editor of the *Business Herald*, writing for another newspaper a couple of weeks ago, asserted that it is "bad financial management to sell productive assets to fund projects that could be funded more cheaply by debt". This statement ignores risk. Debt is not cheaper than equity once risk is taken into account; otherwise debt finance would be unobtainable. If this writer followed his own logic he would fund "productive" assets entirely from "cheaper" debt, and likely bankrupt himself in the first recession that came along.

The debate over asset sales is a debate over ownership, not the assets. Economists widely agree that ownership matters. The argument that politicians make poor businessmen and women is so obvious as to scarcely need any elaboration. Politicians commonly have little or no commercial expertise and their foremost incentive is to get re-elected. Board appointments are too often politicised, as may be an SOE's objectives and its investment, remuneration or pricing decisions. The absence of any market test of what is happening to the value of the firm or the return on capital, allows taxpayers' capital in SOEs to be destroyed non-transparently.

A partial sell-down of the government's ownership in SOEs that led to their shares being traded on a stock exchange would reduce this information void, and thereby the ability of politicians, boards or management to destroy shareholder value with relative impunity. The company would be less open to wealth-reducing political interference, and company

management could be better focused on wealth creation. The public would experience the benefits of better information about value.

A Treasury report last December concluded that "reducing Crown ownership of the commercial portfolio would provide moderate economic gains".

In an address this year to the Law and Economics Association, Wellington economist, Phil Barry, reviewed the literature on partial privatisation and concluded that most studies find "significant performance gains".

But while partial sales are good, New Zealanders could expect even greater benefits from a full sell-down. Complete divestment removes the conflict between politicians' ownership and regulatory interests. It also removes the potential conflict between a politically-motivated government shareholder and fully commercial shareholders. It can also ensure that the Crown can secure, should it wish to do so, the premium associated with passing over effective control of the company.

Barry reviewed the empirical economic literature on full privatisation for the Business Roundtable in 2002 and concluded succinctly that the raft of studies done "shows overwhelmingly that, on average and over time, the performance of privately owned businesses is superior to state-owned ones". Productivity is enhanced, competitors are empowered, lower unit costs allow sustainably lower prices to customers and product variety and service quality can be greatly improved. (Some Auckland readers will remember long waiting lists under the old Post Office monopoly to get the only phones on offer - black.)

Both the columnists mentioned above argued that SOEs are already competitive, without offering a shred of systematic evidence on this point or explaining why political ownership imperatives would not have commercial consequences. Both cited Air New Zealand as proof of the value of government ownership. However, although Air New Zealand is innovative and apparently performing well operationally, it has not been making an adequate return and Treasury numbers indicate that its value more than halved between 2007 and 2010. Airlines are risky investments and many taxpayers would prefer that the burden of such losses fell on private investors - which is what asset sales should do.

A final telling point is that the Crown Ownership Monitoring Unit's 2010 review of the performance of the SOE portfolio frankly states that the unit's measure of the portfolio's five-year performance is not "particularly robust". The very fact that it has no robust measure decades after the SOEs' establishment makes it clear that non-commercial imperatives have been dominant. As any Olympic archer would tell us, you can't expect to hit a challenging target if you are not aiming at it.

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