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State-Owned Enterprises and Privatisation

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STATE-OWNED ENTERPRISES AND PRIVATISATION

Only 20 or so years ago there was fierce debate over whether state control or the market was the superior economic system. Khrushchev's boast to the West was "We will bury you" by the turn of the century. That debate has of course ended with the opening of the Berlin wall and the total collapse of the Soviet Union.

Similarly there was fierce debate over the relative performance of public and private enterprise. Many people argued for nationalised industries on the grounds that the state could run businesses as efficiently as the private sector. Unbelievably, some academics in New Zealand and people like Brian Easton and Len Bayliss continue to do so, and as recently as the 1970s successive New Zealand governments were still creating state-owned businesses such as Petrocorp and the DFC.

Starting in Britain, the 1980s saw worldwide moves to privatisation. Some 7,000 state businesses have been sold in the period, and the process is escalating in Latin America, Africa, Eastern Europe and the Soviet Union. As John Moore, a former minister in the Thatcher government, recently put it:

"In my view, the argument about state versus private industry... is over. Private ownership has won... The reason that the political contest over privatisation came to an end is simply that implementation succeeded. Facts overtook the debate."

New Zealand has made large gains in recent years by requiring state-owned enterprises to be run as successful businesses and exposing their markets to competition. As a model, the New Zealand policy of corporatising state-owned enterprises (SOEs) is probably the best that can be devised, given continued public ownership, for getting satisfactory returns on taxpayers' investments while still enabling non-commercial goals to be pursued. The efficiency gains made, including those in very large entities such as Telecom and Electricorp, have been on a scale which has had a major positive impact on the whole economy and its international competitiveness.

Nevertheless, the SOE model is only a half-way house and all experience here and abroad tells us it is not sustainable:

- full commercial disciplines cannot be applied;
- governments are always short of cash and cannot fund expansion;
- in the final analysis they will bail SOEs out at the taxpayers' expense - we have already seen several bail-outs since the SOEs were established;
- political interference will re-emerge - not because politicians are particularly self-serving but simply because the pressures to interfere are enormous when businesses operate in a politicised environment;
- as a result, the commitment of commercial boards and managers falls away, conflicting objectives are re-introduced, the drive for productivity and innovation dissipates, and the organisations effectively revert to their former government department status.

Of course the private sector also makes mistakes but the incentives to avoid them and to correct them faster are greater. Only full privatisation can guarantee superior performance over the long run. As the World Bank has put it in a just-released study:

"... private ownership makes a difference. Some state-owned enterprises have been efficient and well-managed for some periods, but government ownership seldom permits sustained good performance for more than a few years. There is a higher probability of efficient performance in private enterprise."

The reasons for superior performance are many. They include capital market disciplines, the threat of takeover and bankruptcy, the freedom from political interference, and the ability to develop a clear strategic direction and a new organisational culture. These incentives need to be strengthened by the creation of a more competitive business environment, and appropriate regulation in the limited number of cases where genuine monopoly problems may arise.

The arguments raised against privatisation have been shown to be unfounded:

- prices have not gone up; the gains from corporatisation have been locked in and enhanced;
- the gains have not been at the expense of overall employment. Overstaffing in the public sector has cost jobs elsewhere because of the excessive public sector charges, direct and indirect, faced by the private sector;
- slogans like 'selling the family silver' are empty. Many of the former SOEs were liabilities rather than assets. The sales have enabled public debt to be repaid - debt we just cannot afford to carry.

Although some of the sales were controversial at the time, generally the sale process has been well handled and much expertise in preparing for and managing sales has been built up. Those that have been sold - such as Air New Zealand, Government Print, Telecom, Rural Bank, Petrocorp - are all now doing a far better job for consumers.

I can tell you from my Air New Zealand experience that genuine international competitiveness in terms of both cost efficiency and service quality simply would not have been achieved and maintained in government ownership.

If Air New Zealand had remained government owned, the difficult domestic and international market environments of the last couple of years would have seen the erosion of close to half of the business's shareholder funds - that is around a quarter of a billion dollars - and it would still have been a mediocre market participant. This level of losses would have required a capital injection of \$200-\$300 million by the taxpayer just to keep what would have remained an average business in business. This was an exposure that the New Zealand public could not afford and did not deserve.

Against this sort of experience you will understand why I say onward - and at speed - with the privatisation process.

The government's privatisation programme has been lagging and it is essential that it be given a new impetus. This is needed to achieve further efficiencies and help ease the fiscal problem, which without doubt remains a prime threat to a sustainable recovery.

There would be no difficulty in maintaining a well-conceived series of privatisations over the next 1-2 years. Many SOEs are ready for sale, the sharemarket could absorb a significant programme of sales and, done properly, they will increasingly attract off-shore capital.

There is no reason for the government to back off candidates for privatisation that may be more sensitive such as New Zealand Post and Electricorp. Literally dozens of countries are currently engaged in electricity privatisations. Many are moving on to areas like water and health services - for example the government of New South Wales is looking at its first hospital privatisation. If we do not want to fall further behind we must press on with all possible speed.

There is a shared political and business sector responsibility to convince a sceptical public that the resumption of a vigorous privatisation programme would yield real benefits. The evidence here and around the world is all positive. It would be an excellent signal that the government really does have a vision for New Zealand, is looking beyond the next election and is not resting on its oars.

To its credit the government has taken many of the right economic decisions and the benefits are showing up in a steadily improving economic outlook. But time is not on our side in dealing with the grave problems of high unemployment, high debt, and high real interest rates. New Zealand is still a very vulnerable economy. A strong privatisation programme is an obvious means of easing these problems and consolidating the prospects of a solid economic recovery.

We must get honest. We need to isolate our welfare and social policy programmes from the public sector businesses, which primarily exist to provide marketable goods and services. We should get the appropriate regulatory frameworks in place and get on with the privatisation process.

It is not just economically and fiscally right to do so. In my view it will also prove to be politically right as it will confirm that the government has the will to get on with strategies which are mandatory if we and our successors are not going to drift further towards third world status.