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**PRIVATISATION: A FORGOTTEN POLICY?**

**ROGER KERR  
EXECUTIVE DIRECTOR  
NEW ZEALAND BUSINESS ROUNDTABLE**

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# PRIVATISATION: A FORGOTTEN POLICY?

## An Argument Won

*"Privatisation has undoubtedly improved efficiency and led to greater consumer focus"*

Fabian Society<sup>i</sup>

All over the world today, governments are engaged in privatisation. In the ten years to 1995, total sales of state-owned enterprises amounted to US\$535 billion.<sup>ii</sup> That's an unprecedented shift of resources from the public to the private sector.

And the pace is still accelerating. In the March 1997 issue of *Financial Market Trends*, the OECD estimates that privatisations in its member countries, already at an all-time high last year, could reach a record US\$100 billion in 1997. It expects this total to be boosted by a rebound in privatisations in non-OECD countries, notably Brazil.

Latecomers to privatisation have joined in. In 1996 privatisations in OECD countries rose by nearly 30 percent, with most occurring in Europe. Holland has privatised its postal service and Sweden has moved two of its public universities into private non-profit trusts. Last year privatisations in Australia amounted to US\$9.6 billion according to the OECD, and are expected to amount to a further US\$7.1 billion this year. In just two years asset sales in Australia will have exceeded in value New Zealand's entire privatisation programme since 1987.

In addition, there is huge private investment around the world in infrastructure projects - roads, water and sewerage, electricity, ports, airports and so forth. One Australian banking firm recently put the all-up value of prospective federal and state projects in that country involving private sector participation at A\$75 billion.<sup>iii</sup>

Although privatisation is often considered an ideological issue, in fact it has become non-partisan and non-ideological. It has been embraced by governments of all political persuasions, including socialist governments in Spain and Sweden, populist governments in Argentina and Mexico, former

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<sup>i</sup> Quoted in Department of Trade and Industry, *Privatisation: Setting Enterprise Free*, London, February 1997.

<sup>ii</sup> John O'Leary (ed), *Privatization 1995*, Reason Foundation, Los Angeles, 1995.

<sup>iii</sup> 'Jobs Swap in Privatisation Race', *Australian Financial Review*, 26 March 1997.

communist governments in Russia and Eastern Europe, and even by the few remaining communist governments such as China, Cuba and Vietnam. Robert Poole of the Reason Foundation, Los Angeles, noted in a paper given in New Zealand last year that at both federal and state level in the United States privatisation has become a non-partisan issue.

The contrast between the current state of affairs in New Zealand and these developments around the world could hardly be more striking. At central government level the coalition has no firm plans to privatise anything. At the local government level there are few significant initiatives in the pipeline. The Auckland Regional Services Trust (ARST), which was set up with the explicit task of divesting most of its assets, is showing every sign of wanting to sit on them and perpetuate its existence.

With the exception of ACT New Zealand, none of our significant political parties is strongly committed to privatisation. I don't recall a single speech by Philip Burdon as minister of state-owned enterprises or Bill Birch as minister of finance in the last government cogently arguing the case for it. This year ministers have been falling over themselves telling us what they're *not* going to privatise - from the government's electricity businesses and TVNZ to ACC. In a few years' time New Zealand will probably be the only respectable country with a largely government-run electricity system. We look like becoming the dunce of the class again. Warren Kyd, who has been arguing for ACC to be privatised, and David Hawkins, who has been advocating and implementing privatisation in Papakura, stand out like isolated beacons of light on the issue.

Why has New Zealand so comprehensively dropped the ball on privatisation while the scores are mounting around the world? Clearly the answer is not that there is nothing left to privatise. As the Treasury noted in its briefing to the incoming government, state-owned enterprises are a major component of both the central government's balance sheet and the wider economy. Their total revenue equates to *over* 5 percent of GDP. As at June 1996, their assets of \$12.5 billion comprised 21 percent of the book value of total government assets and were equivalent to about 28 percent of the asset book value of the New Zealand Stock Exchange's top 40 group of companies. I would be surprised if the ratio of the capitalisation of government-owned companies to private listed companies came to anything like that figure in most, if not all, other OECD countries, and in most Asian countries as well.

At the local government level, just to give two examples of the scale of publicly owned businesses, the net assets of the ARST amount to around \$540 million or

over \$1500 for every household in the Auckland region, and the investment by local government in water supply and wastewater assets is of the order of \$6 billion, larger than the total investment in Telecom's network. Clearly a significant fraction of the New Zealand economy, which could be run by firms and business people in the same way as other businesses, continues to be run by governments and politicians.

Similarly, the resistance to privatisation in New Zealand cannot be explained by the argument that the evidence in favour of privatisation is not clear-cut. Fifteen years ago it might have been possible to make that argument with some degree of plausibility. Only Britain at that time had embarked upon privatisation as a major policy. The argument largely had to be carried on theoretical grounds. Today there is a mass of practical and empirical evidence to draw on. It is this evidence which has led most countries around the world to go down the privatisation road.

There is no need to spend time rehearsing at length the benefits of privatisation to this audience. They were well summarised in the recent Treasury briefing paper. The standard result from almost all studies is that while gains can be made from running state enterprises as arm's length businesses, further gains can be made from privatisation. As one major study put it, "ownership does matter for both technical and allocative efficiency".<sup>iv</sup> Large scale studies by the World Bank have confirmed that private ownership is a significant determinant of economic performance.<sup>v</sup>

Similar evidence is now available for New Zealand. A study of Telecom concluded that the annual gains to the New Zealand economy from its restructuring are now running at around half a billion dollars.<sup>vi</sup> It also found that productivity gains in Telecom since privatisation have been at least as large as those of the SOE period and that consumers have received the bulk of the benefits, largely through real price reductions. Without doubt, studies of companies like Air New Zealand and Tranz Rail would also show spectacular gains. In addition to the benefits to consumers, owners have benefited from higher returns and the government has benefited from much higher tax

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<sup>iv</sup> Vining, A R and Boardman, A E, 'Ownership versus Competition: Efficiency in Public Enterprise', *Public Choice*, Vol. 73 (1992), pp. 205-239.

<sup>v</sup> World Bank, World Development Report 1996, p. 49.

<sup>vi</sup> de Boer, David and Evans, Lewis, 'Government Department to Public Corporation in a Deregulated Economy: The Economic Efficiency of New Zealand Telecommunications', mimeo, 1996.

payments - an additional \$100 million annually in Telecom's case. There have been environmental benefits as well.

Clearly, logic and evidence cannot explain the resistance to privatisation that is still apparent in New Zealand. What then are the explanations?

I think the answers fall under two headings: ideological attitudes on the one hand, and misinformation and misunderstanding on the other.

We have to remember why governments became involved in running nationalised industries in the first place. A hundred and fifty years ago, governments by and large saw their job as being to provide public goods, not to run businesses. Major new industries of the time such as railroads, electricity and telecommunications were all developed privately. But under the influence of Marx and later the Fabians, who naturally could point to faults in a world that will never be perfect, governments began to think they could do a better job of running many businesses than the private sector. To varying degrees they took them over - in the Soviet Union they nationalised practically the whole economy.

The socialist vision has remained powerful for much of this century. It was expressed, for example, in Clause Four of the British Labour Party's constitution, which was printed on the back of every member's party card:

To secure for the workers by hand or by brain the full fruits of their industry, and the most equitable distribution thereof that may be possible upon the basis of the common ownership of the means of production, distribution and exchange, and the best obtainable system of popular administration and control of each industry or service.

Tony Blair had to engage in a monumental struggle as recently as two years ago to persuade the British Labour Party to drop Clause Four. He was aided by the fact that even the Fabian Society in Britain has been forced to acknowledge the success of privatisation.

Experiments in state ownership have been a failure almost everywhere they have been tried. At worst, as in the Soviet Union, they have led to famines, grinding poverty and brutal coercion. At best, as in Britain and New Zealand, they took the form of state enterprises characterised by poor and costly services, chronic losses, union monopolies and arrogant attitudes towards

consumers. In the light of these experiences, as Lord Robert Skidelsky, the author of *The World After Communism*, has put it:

... governments in developed and developing countries alike have been privatizing their public sectors and shredding their instruments of intervention and control. The aim of economic reform is remarkably similar everywhere: a market economy based on private ownership, with accountable governments limited to relatively few functions.

But the ideological nostalgia for common ownership lives on in New Zealand, especially among the older generation. More than most other western countries, New Zealand embraced state socialism, and adherents can still be found in the newspapers every day. Thus Alliance candidate Patrick Mooney tells us that "the Business Roundtable will not be satisfied until the few remaining people's assets (*sic*) are sold off." Productions like the Frontline 'For the Public Good' television programme and the ridiculous film 'Someone Else's Country' are still being made by the ideological Left. An Auckland church leader solemnly told me last year that he thought privatisation was a plague that had suddenly hit the world. Brian Easton has come round to approving commercialisation, but I suspect he will go to his grave denying that privatisation offers greater benefits. There is nothing that can be done about such people. Their resistance to privatisation is ideological. It will not be shaken by logic and evidence. We must concentrate on those whose minds are open to reasoned argument.

What, then, are the sources of misinformation and misunderstanding that trouble open-minded people? Let me deal briefly with a short list of them.

First, some may be influenced by the claim that "greedy businesses" just want to get their hands on "cheap assets". But investors in New Zealand and abroad have access to a worldwide market for existing business assets and new investment projects. There's no reason why they should have a special interest in New Zealand state enterprises. All of them have been sold through open and competitive sales which produced fair value for taxpayers. Like any range of investments, many have turned out well after the event for their new owners while some clearly did not justify the sale price. That's business.

And for those who are hung up on this issue, there is a further response. With market sales, the proper use of proceeds is to return them to the true owners of the businesses, taxpayers or ratepayers, through debt or tax reductions. An alternative, widely used in Russia and some other countries that have divested

state businesses, is simply to give shares in them directly to taxpayers or ratepayers. Those who go on about "greedy businesses" are remarkably silent about their objections to this approach. I suspect the reason is that, contrary to their rhetoric about democratic decision-making, they are not enthusiastic about the idea that people should actually be allowed to make investment decisions for themselves, and want to maintain political control instead.

Secondly, many politicians like to say they are doing a good job with their SOEs and LATEs: they are now running efficiently and making money. Why privatise? We have already seen the answer: privatisation offers further gains. The reasons are elaborated in a recent study by Professors Barry Spicer, David Emanuel and Michael Powell of Auckland University:

Privatisation can be viewed as a means of further economising and locking in future gains by strengthening incentives, opening up access to capital, and subjecting stock-exchange listed companies to equity market disciplines, including the market for corporate control.<sup>vii</sup>

They also make the point that, over time, politics typically intrudes on commercial decision-making in publicly owned businesses. On average, private businesses perform better, and politicians should not bet against the odds.

Thirdly, some people oppose privatisation on the grounds that some publicly owned businesses are monopolies. For example, Harry Julian of the ARST is on record as opposing the sale of the Auckland port company on the grounds that it is a monopoly. But monopoly is an issue of market structure, not ownership. It should be dealt with by removing all artificial barriers to competition, by applying the disciplines of the Commerce Act, and by supplementing them with disclosure or other limited regulation in exceptional cases. In fact it has been clear since corporatisation that there is plenty of competition in the ports industry, and no new issues arise with privatisation - indeed Ports of Auckland Limited is already partly privatised. The Treasury has noted that among existing SOEs only Transpower and parts of the Airways Corporation pose significant monopoly problems. These problems are not insuperable and it is noteworthy that the Airways Corporation and Ports of Auckland, as well as New Zealand Post, are among the highly successful companies that have publicly stated that they believe they could do an even better job if privatised.

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<sup>vii</sup> Spicer, B, Emanuel, D and Powell, M, *Transforming Government Enterprises*, Centre for Independent Studies, Sydney, 1996, p. xi.

A fourth argument that is still heard is that prices will go up with privatisation because the businesses will have to pay dividends and tax. At base, this is another of the legacies of socialism and the distaste for the profit motive: the belief that goods and services would be cheaper if firms did not have to make profits. Experience has shown that goods and services are produced most cheaply by firms seeking profits in competitive markets, and privatised businesses are no exception. Even more fundamentally, there needs to be a normal return on capital in any investment, regardless of whether it is in the public or private sector, if society's resources are to be allocated to their best use. The profit element is not removed by nationalisation and the true cost of the product or service cannot thereby be lowered: all that can happen is that someone else pays for it. So this argument too is without any substance.

The fifth and final argument that I will deal with is that privatisation worsens a government's financial position. Today this argument is only heard at the local government level. For example, Alister James, Chairman of Christchurch City Holdings, was recently quoted as saying that a sell-down of assets would have a "longer term disadvantage in loss of dividend income", with the implication that rates would have to rise. This argument is self-evidently wrong. While a council loses a dividend stream with an asset sale, it also loses a debt servicing obligation, and because the sale price will incorporate the higher expected earnings stream of the asset under private ownership, the council's financial position will improve. It is hard to credit that this argument still has legs given the contribution which privatisation has made to lowering central government's debt and taxes and strengthening its financial position.

These are some of the core persisting forms of misinformation and confusion about privatisation. There are other objections such as that privatisation creates unemployment, that control of 'strategic' assets will be lost to foreigners, that social objectives will be sacrificed, that 'necessities of life' should not be privatised and so forth, which I have discussed elsewhere.<sup>viii</sup> And I have not mentioned a number of other benefits of privatisation which have become more apparent over the years, such as the benefits to firms of being set free to pursue long-term and international business strategies; the creation of global opportunities for firms and professional advisers such as yourselves to capitalise on New Zealand's privatisation experience; the deepening of the New Zealand capital market with benefits for superannuation funds and other

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<sup>viii</sup> See, for example, Kerr, R L, 'The Case for Accelerating the Privatisation Programme', AIC Conferences Crown Enterprise Summit, 28 October 1993.

investors; and the freeing of the time of central and local government politicians to concentrate on their core roles. A fuller discussion of privatisation should also include the many forms it can take other than divestment of government assets, such as competitive tendering for services, contracting out, and a range of options for private involvement in infrastructure provision.

My conclusion is that if New Zealand is to resume an active programme of privatisation - as urged by the OECD, most New Zealand business organisations and, I suspect, most of the government's departmental advisers - there will have to be a great deal more public discussion both of the benefits of privatisation and public misconceptions about it. The silence on the issue is deafening. Where are the academics and business leaders pointing out the benefits of privatisation? Why does the National Party project itself as a private enterprise party yet its long-term record - from the time Radio Hauraki had to go to sea to force the issue on private radio to the present day - is one of words not matching deeds? If, as the government argues, selling six small power stations is a good idea, why wouldn't selling six big ones be an even better one? As the party purporting to represent the lower income sector, why is Labour not pointing out the benefits of privatisation to consumers and promising more, as Labour leader Tony Blair is doing in Britain? He has been contemptuous of:

... those Labour diehards who went on arguing for nationalisation and statism long after their irrelevance was plain to the rest of the world.

And when did we last hear from the Consumers Institute on privatisation? It is little wonder that privatisation is often perceived as unpopular in New Zealand when the field is left to those who spread myth and misinformation.

It is not just politicians who come out with knee-jerk reactions against privatisation; some media commentators, for example, are equally guilty. Two years ago the Business Roundtable published a report on the Fire Service which canvassed a range of options for improvements to one of the worst-run government organisations, including a brief discussion of options for private provision. It was greeted with a vitriolic editorial by the *Evening Post*, which advised its readers that:

The Fire Service is already in the process of painful reform, and should get on with the job without the attentions of Business Roundtable types. Targeting service industries and a fixation with costs is a hallmark of

Roundtable thinking. It seems to have a curious interest in turning New Zealand into a no-State laboratory, where social responsibility is anathema and no one takes obligation or responsibility for anything.

Apart from the extraordinary suggestion that a country where the government spends one third of national income is getting close to being a no-state laboratory, the editorial showed an appalling ignorance of fire service issues. Our report had much in common with the independent McCaw report of 1993 commissioned by the Fire Service itself, whose recommendations have never been taken up. In respect of private options, anyone who knows anything about fire services would be aware that half Denmark's fire services are provided by a private company, Falck, which also operates internationally, and that the ratio of the costs of fire services to GDP in Denmark is about half New Zealand's.<sup>ix</sup> There are many other examples of private fire service provision. To be fair, in more recent editorials the *Evening Post* has been critical of the Fire Service's performance. However, it has yet to recognise that the so-called "painful reforms" have come to nothing; that the Fire Service's budget is again blowing out; and that nothing will change until the kind of reforms canvassed in our report and the McCaw report are implemented. And newspapers are not very good at saying 'sorry' for getting things wrong.

What is particularly galling about the fire service example is that this year the government of the state of Victoria has been looking at privatising or contracting out part of Melbourne's Metropolitan Fire Brigade. It has been doing so on the basis of a report by the accounting firm KPMG, presumably yet another 'New Right' organisation committed to a 'minimalist state'. Victoria has been pursuing a vigorous privatisation programme with strong public support, and there is no sign that it is stopping. The huge City Link private roading project in Melbourne is now well underway, two ports have been sold, most of the electricity generation sector has been privatised, and the Kennett government has just announced plans to privatise the state's high voltage electricity grid, PowerNet Victoria, by the end of this year.

Elsewhere in Australia there are similar moves. Qantas has been privatised. The banking sector is now mostly in private hands with the sale of the Commonwealth Bank and most state banks in recent years. The Federal government has commenced the sale of Telstra and plans to sell its rail and shipping interests and the major airports. Australian governments are ahead of New Zealand with reforms in roading and water, including forms of

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<sup>ix</sup> New Zealand Business Roundtable, *The Provision and Funding of Fire Services: Some Broader Perspectives*, New Zealand Business Roundtable, 1995.

privatisation. And, as in many other countries, reforms are now moving into the area of social services. The Commonwealth Employment Service is being contracted out. The *Australian Financial Review* reported in February that "the idea of privately run prisons is gaining strength in Australia",<sup>x</sup> and the Court government in Western Australia is committed to continuing with the privatisation agenda that marked its first term, with particular reference to hospitals.<sup>xi</sup>

What makes these Australian examples even more mortifying is that Australia is far from being a leader in privatisation or microeconomic reform generally. Today the pace is being set by many countries in Asia, Chile, a number of state governments in the United States - Michigan, for example, has recently privatised its workers compensation scheme - and some countries in Eastern Europe. Many commentators in Australia are frustrated that its governments are not doing enough. But Australia provides a measure of how far New Zealand has fallen behind the pace. As an Australian said at a recent conference I attended: "I'd heard about all these reforms going on in New Zealand but I've lived here for three years now and nothing has happened."

The parties to the coalition government have an ambitious vision for New Zealand. The National Party has set itself the target of achieving 3.5-5 percent annual growth to the year 2010, and New Zealand First aims to achieve 6 percent growth by 1999. Such targets are feasible, but only if reforms are pushed ahead: there is not the remotest chance that sustainable growth of anything like 5-6 percent a year will be achieved on present policies. All the government's economic advisers will be telling it that any strategy for achieving such goals must include a vigorous programme of privatisation.

Sustained economic growth is the only feasible means for any country to improve overall living standards. On present trends, Australia is likely to achieve higher growth than New Zealand in the foreseeable future. If New Zealanders want to vote against privatisation and other policies which will make them stay relatively poor, I have no problem with that as a matter of democratic choice. But they should realise what they are doing, and they should not complain when Australian living standards far outstrip ours and when most of our young and enterprising people are 'over there'.

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<sup>x</sup> 'Privatised prisons are a matter of conviction', *Australian Financial Review*, 27 February 1997.

<sup>xi</sup> 'Court pledges agenda for WA prosperity', *Australian Financial Review*, 17 January 1997.

