# THE CHANGING BALANCE

## BETWEEN THE PUBLIC AND PRIVATE SECTORS

PHIL BARRY

NEW ZEALAND BUSINESS ROUNDTABLE

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## Acronyms

| | |
|---|---|
| ACC | Accident Compensation Corporation |
| BBC | British Broadcasting Corporation |
| CNI | Central North Island Forest Partnership |
| COE | crown-owned entity |
| FCNZ | Forestry Corporation of New Zealand |
| GDP | gross domestic product |
| IEA | International Energy Agency |
| IMF | International Monetary Fund |
| IPO | initial public offering |
| NZISCR | New Zealand Institute for the Study of Competition and Regulation |
| NTT | Nippon Telegraph and Telephone |
| OECD | Organisation for Economic Cooperation and Development |
| PPP | public–private partnership |
| SOE | state-owned enterprise |
| TVNZ | Television New Zealand |

## ABOUT THE AUTHOR

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*Ownership matters, but it is not the only thing which matters*

World Bank

# 1

# INTRODUCTION

In the early 1990s, the World Bank identified four prerequisites for achieving sustainable economic growth:

- sound macroeconomic policies;
- competitive domestic markets and openness to international trade;
- more and better private and public investment in people; and
- achieving the 'right' balance between the roles of the public and private sectors.[1]

This paper considers the fourth of these prerequisites for growth: achieving the best balance between the public and private sectors.[2]

There is no magic formula for determining the 'right balance' between the public and private sectors. The answer will be different for different countries and will change over time. Further, governments have many tools whereby they affect the balance, including taxation, subsidisation, regulation and ownership of activities. Which, if any, tool the government should use in a particular case requires a careful evaluation of the costs and benefits of government intervention and an evaluation of the different types of intervention.[3]

While there is no simple answer to the optimal balance between the public and private sectors, one clear trend over the last decade has been the marked withdrawal of governments from owning commercial businesses.[4] Since 1990, more than one trillion US dollars worth of assets in commercial enterprises has been transferred to private ownership.[5] This process of privatisation represents a huge transfer of assets from the control of governments to the private sector.[6]

Almost every country has adopted privatisation as a policy at some stage over the last 20 years. The World Bank notes that "privatisation is now so widespread that it is hard

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1 World Bank (1991).

2 As the World Bank notes, "It is not a question of state or market: each has a large and irreplaceable role", World Bank, *op cit* p 1.

3 The costs and benefits of government action should be broadly defined and include the impacts on democracy and individual liberty.

4 For a broader discussion of the overall direction of public policies in countries that are part of the Organisation for Economic Cooperation and Development (OECD) over the last decade, see Barry (2001); for a review of the impact of government spending on economic performance, see Bates (2001); and for an analysis of regulatory reform, see Wilkinson (2001).

5 Gibbon, H (2000), p 1.

6 In this paper, privatisation is defined as the deliberate sale or gifting of the shares or assets of state-owned enterprises to private economic agents.

to find countries not using the approach: North Korea, Cuba and perhaps Myanmar make up the shrunken universe of the resistant".[7]

But just because 'everyone is doing it' doesn't necessarily make it right. The purpose of this paper is to examine the evidence on whether privatisation 'works' and to consider what factors make privatisation work better. By 'works' we mean does privatisation tend to make the business more efficient, enhance the competitiveness of markets and increase overall economic welfare.

A large number of empirical studies on the effects of privatisation have been undertaken over the last two decades. It is now possible to compare the performance of companies before and after they became private in various parts of the world, in countries with different cultures and at different stages of development. It is also possible, although more difficult, to estimate the impact of privatisation on overall economic welfare.

This paper first examines the state of privatisation internationally. Next, the evidence is surveyed on the effects of privatisation, both in New Zealand and in other countries. We then address the concerns that have been raised about privatisation before considering what factors are likely to make privatisation most successful. Finally, we look at the emerging trend towards public–private partnerships (PPPs) to see how they compare with privatisation or public ownership.

[7] http://rru.worldbank.org.resources.impact of privatisation.

# 2

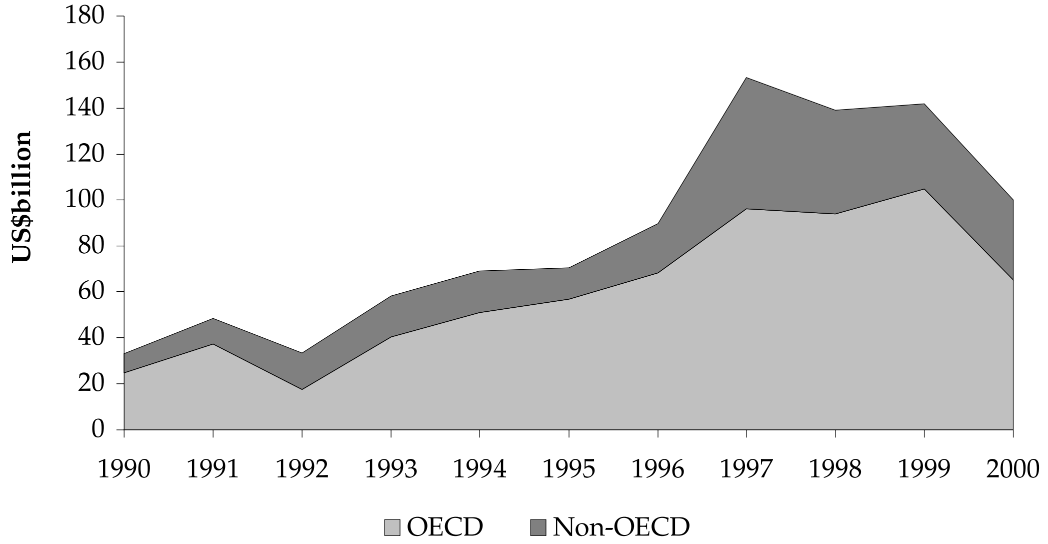
# WHAT'S BEEN HAPPENING AROUND THE WORLD?

The first major modern privatisation programme is generally attributed to the UK government in the early 1980s.[8] Since then, governments in over 100 countries have used privatisation as an instrument of public policy.

As a result of privatisation, the share of state-owned enterprises (SOEs) in global gross domestic product (GDP) has declined from around 12 percent in 1979 to less than 6 percent today.[9]

The pace of privatisation picked up significantly during the 1990s. Between 1990 and 1999, annual global proceeds from privatisation grew more than fourfold (see figure 1 below). In 2000, the proceeds generated from privatisation worldwide declined, partly because of volatile global equity markets and partly because governments in the richer nations had fewer businesses to sell.

Figure 1: Global proceeds from privatisation




*Sources*: OECD and World Bank.

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8 There were several earlier individual instances of privatisation, including the denationalisation of the British steel industry in the early 1950s and the sale by the government of the Federal Republic of Germany of a majority stake in Volkswagen in 1961.

9 Megginson and Netter (2001), p 328. These figures, however, overstate somewhat the extent to which governments have withdrawn from industry as many governments, especially in continental Europe, have retained at least for a period, so-called 'strategic holdings' or controlling interests (for example, through 'golden shares' that give veto rights against a take-over of the company). See 'Coming home to roost', *The Economist*, 29 June 2002.

Privatisation is now being followed by governments across the globe and regardless of the ideology of the government of the day.

To highlight a few recent examples from countries belonging to the Organisation for Economic Cooperation and Development (OECD) with centre-left governments:

- in France the privatisation programme under the recent Socialist government realised around $50 billion over the last five years: more than under any preceding government. Major transactions in 2000/01 included the public offering of Thomson Multimedia (electronics) and the state-owned bank, Banque Hervet;
- in Germany the pace of privatisation has picked up under the Social Democrats: Deutsche Post has been listed on the stock exchange, and Deutsche Bahn Housing (a housing company catering for state railway workers) and further holdings of Deutsche Telekom were sold;
- the Blair government in the United Kingdom partially privatised the air traffic control system,[10] the London underground rail system is to be partially privatised, most of the government's defence research laboratories are being sold and the British Broadcasting Corporation (BBC) is planning to sell up to 49 percent of its commercial arm, BBC Worldwide and the beeb.com internet service;
- the Labour government in Norway approved the sale of up to 33 percent of Statoil, the state-owned oil company; and
- in New South Wales, the Labor government has recently sold Freightcorp, the state rail freight carrier, and its shares (20 percent) in National Rail Corp, the interstate operator. It tried to sell its electricity operations but was blocked by union and other interests.

Across non-OECD countries, privatisation has been widespread in South America, Asia, eastern Europe, the former Soviet Union, the Middle East and to some extent Africa. Even the communist government in China is attempting to restructure – and has plans to partially privatise – large numbers of its SOEs, although there is considerable resistance to change amongst the numerous loss-making state enterprises.

In summary, privatisation is being implemented throughout the world and by governments of all political persuasions (refer to Annex 1 for a list of major privatisations planned for 2002/03). While privatisation in all countries is politically sensitive, New Zealand is the only country in the OECD that I am aware of where the central government has a blanket policy not to undertake further privatisations of SOEs.[11]

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10 "More than a dozen countries – including Canada, Britain, Australia and Germany – have either fully or partially privatised air-traffic services", *Time*, 22 January 2001, p 37.

11 Despite the formal ban on privatisations of SOEs, there have, nevertheless, been numerous instances in New Zealand of asset ownership shifting from the central government to the private sector over the last few years. Examples include Treaty of Waitangi settlements; the sale of assets by SOEs and government departments (for example, the sale of some of the land owned by the Ministry of Defence and overseas properties owned by the Ministry of Foreign Affairs and Trade); the auction of the 3G telecommunications spectrum; and the sale of the profitable parts of Terralink, a former SOE that was placed in receivership in 2001.

# 3

# WHY THE SHIFT TOWARDS PRIVATE OWNERSHIP?

Country-specific factors are likely to explain the timing and rate of privatisation of SOEs in individual countries. However, three common factors can be seen to underlie the worldwide boom in privatisation over the last two decades – changing technology; fiscal pressures facing governments; and the experience that has been gained about the relative efficiency of public and private enterprises. These three factors are considered in turn below.[12]

## Changing technology

Many of the technologies of the early twentieth century favoured centrally run monopolies. In industries such as rail, post, telephone and electricity, a centralised, integrated system was often believed to be the most cost effective means of supply. Further, the large sums of money involved made the government the likely source of capital in many countries.[13]

Since then, however, decentralising technologies have become increasingly important. Private automobiles and trucks, for example, have become alternatives to trains. A myriad of private couriers and internet service providers have sprung up to compete with each other and with central postal systems. Fixed telephone networks are giving way to mobile telephony.

Many other goods and services that were provided by public production in the past have become readily able to be supplied by private operators. It is now, for example, feasible to measure the inputs and outputs of an electricity network, hold half-hourly auctions among competing electricity suppliers and settle the requisite accounts. Similarly, the cost of road use can now be measured with transponders and private roads operated accordingly.

At the same time, private capital markets have become much deeper and restrictions on capital flows have been largely removed in developed economies.

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12 For more detail refer to the paper 'Privatisation' presented by Wolfgang Kasper to Arthur Andersen, Sydney, 17 July 2000.

13 For a discussion of the (largely pragmatic) reasons why New Zealand governments got involved in the ownership of commercial operations, see Hawke, 1982.

## Fiscal pressures

Fiscal pressures served as the catalyst for privatisation in many countries. As the old state-owned monopolies in traditional industries (like banking, coal, steel and petrochemicals) matured, they became large drains on the public purse. Instead of being generators of revenue, many became liabilities on a major scale. This was not sustainable.

The fiscal pressures facing governments also mounted as they became more involved in social welfare functions. Owning commercial businesses, however, was found to be a blunt and inefficient means of achieving social objectives. At the same time, privatisation became an easy source of funds for governments seeking to achieve their social and fiscal objectives.

## Experience

A further reason for the increasing acceptance of privatisation was experience. When privatisation got underway 20 years ago, there was only limited empirical evidence of the relative efficiency of public and private enterprises and early studies were often ambiguous. As governments undertook more privatisations, evidence on the net benefits of privatisation became clearer.

The growing evidence on the beneficial impacts of privatisation of SOEs led a former financial secretary to the United Kingdom Treasury to state, ten years ago, that "in my view the argument about state versus private industry in the United Kingdom 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".[14]

That is not to say that privatisation has been problem-free. The concerns that have been raised about privatisation and the lessons that have been learned about how best to implement privatisation are discussed in sections 6 and 7 below. First, we consider in more detail the evidence on the effects of privatisation.

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[14] John Moore, former financial secretary to the Treasury, 'British Privatisation – Taking Capitalism to the People', *Harvard Business Review*, Jan–Feb, 1992, p 120.

# 4

# INTERNATIONAL EVIDENCE ON THE EFFECTS OF PRIVATISATION

A vast number of studies have now been undertaken on the effects of privatisation. These studies are summarised in three recent survey articles: one published in the *Journal of Economic Literature* (*JEL*),[15] one by the OECD[16] and a third by the World Bank.[17]

The *JEL* paper is the most recent and probably the most comprehensive of the three surveys. It examines:

i. ten recent studies of the relative efficiency of public and private enterprises (that is, studies that look at different firms in the same industry). These studies were generally wide ranging, with several examining samples of over 500 firms;

ii. twenty-two different studies of the effects of privatisation in developed economies; and

iii. sixteen different studies of the effects of privatisation in transition economies (in particular, central and eastern Europe and the former Soviet Union).

The findings of the *JEL* paper for each of the three classes of study noted above are summarised below:

i. of the ten studies examining the relative efficiency of private and public enterprises operating in the same industry, eight studies found the private sector firms performed better, while two found no significant difference between the privately and publicly owned firms. None of the studies found the public sector was more efficient;

ii. of the 22 studies that examined the effects of privatisation in developed countries, all but one found privatisation was associated with improvements in the operating and financial performance of the divested firms; and

iii. of the 16 different studies of the effects of privatisation in transition economies, the studies documented "consistent and significant" evidence that private ownership was associated with better firm-level performance than was the case with continued state ownership. Further, foreign ownership was associated with greater performance improvement than for firms where ownership was limited to domestic investors.

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15 Megginson and Netter, *op cit*.

16 Gonenc, Maher and Nicoletti (2000).

17 Shirley and Walsh (2000).

The findings of the *JEL* survey, as presented above, are paralleled by the findings of the OECD (refer to Annex 2) and the World Bank surveys:

- the OECD paper examines 16 studies comparing the relative performance of public and private enterprises: 12 of the studies indicate superior private performance and four are neutral; and
- the World Bank paper surveys 16 studies comparing public/private enterprise performance: 11 of the studies indicate superior private performance and five are neutral.

All three surveys note that the efficiency of private firms relative to public sector firms tends to be greater where markets are competitive. Indeed, none of the surveys reports a single study indicating superior public sector performance in competitive markets. Thus, the gains from privatisation are likely to be greater when governments also remove unnecessary barriers to competition in the markets that the to-be-privatised entity operates in.

As far as less competitive markets go:

- the OECD paper examines 11 studies of public/private enterprise performance in what are described as "industries with non-competitive segments": seven find superior private sector performance and four are neutral;
- the World Bank paper surveys 16 studies in what are described as 'monopolistic' markets. Six studies find private superiority, five find neutral results and five find public superiority.[18]

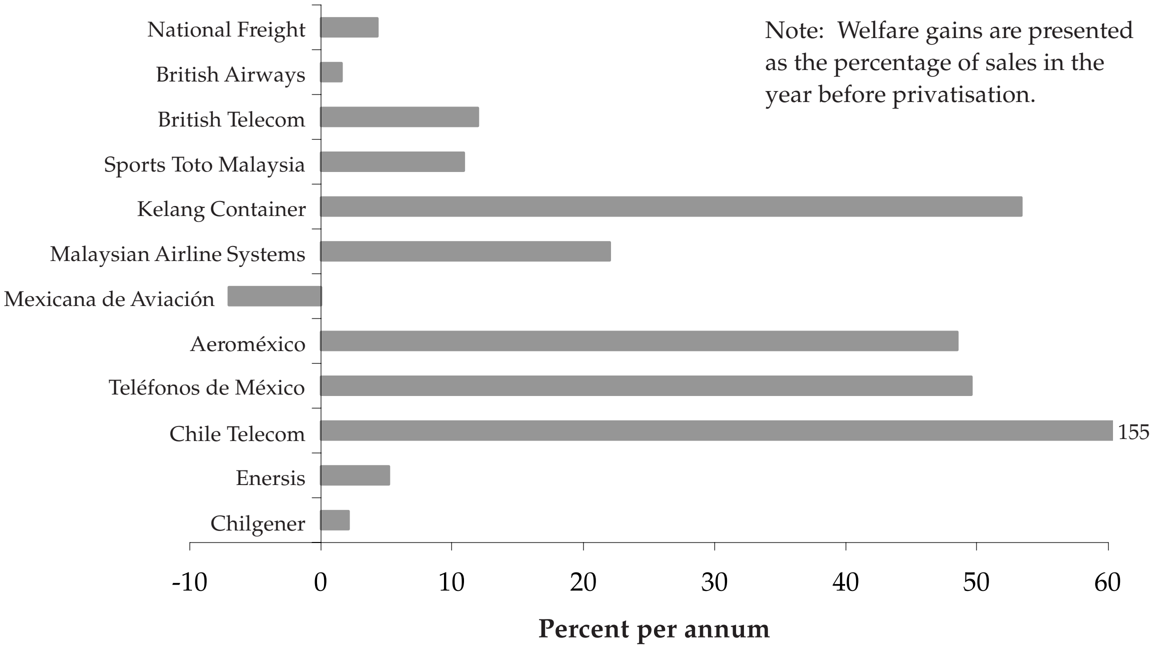
Inevitably there are numerous measurement and methodological problems in the empirical studies covered by the above three surveys.[19] In particular, estimating the net results of privatisation can be difficult because in many countries privatisation has been undertaken at the same time as changes in the business environment, including deregulation. Thus, isolating the effects of privatisation is problematic. However, the findings of the studies that made the best efforts to adjust for such problems are fully consistent with the overall weight of the evidence as summarised above.

Given the data and methodological difficulties, most studies on the impact of privatisation limit themselves to examining the impact of privatisation on the firm itself. Relatively few studies tackle the broader impact of privatisation on the economy as a whole. But those that do examine broader economic impacts find that privatisation enhances economic welfare in almost all cases. The most comprehensive and rigorous study of the economic welfare effects of privatisation is one sponsored by the World

18 The five studies finding public superiority were undertaken in 1985 or earlier.

19 The problems that can be encountered include a lack of good quality and consistent data (for example, studies often must rely on accounting data), explanatory variables being omitted from the analysis, selection bias (for example, the best firms being privatised first) and difficulties in specifying and measuring the appropriate counter-factual.

Figure 2: Welfare effects of selling state-owned enterprises




Bank.[20] That study examined the net economic impact of privatisation in 12 large firms – mostly airlines and regulated utilities. The authors find net economic gains in 11 of the 12 cases (see figure 2).[21] The gains are large, equalling, on average, 26 percent of the firms' pre-divestiture sales.

It is not possible to quantify the 'average' size of the impact of privatisation given the variety of methodologies adopted by the different studies. But the *JEL* study usefully compares the results of three studies that adopted similar methodologies. These three surveys examined a total of 211 privatised firms, comparing their three-year average performance pre-privatisation with that post-privatisation (refer Annex 3). On average:

- the profitability of the firms (measured by net income as a percentage of sales) increased from 8.6 percent to 12.6 percent;
- sales per employee increased by 19 percent;[22]
- investment by the firms increased from 14 percent to 19 percent of sales; and
- the number of employees engaged by the firms increased by 1 percent.

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[20] Galal *et al* (1994).

[21] The case that didn't demonstrate welfare gains was Mexicana de Aviación which was sold to a buyer who made many unwise decisions and lost a lot of money before the company was sold and eventually turned around. This illustrates the point that private managers make mistakes just as public managers do, but under private ownership losses are limited by bankruptcy and restructuring, whereas under public ownership such losses can be tolerated indefinitely.

[22] Note that this increase in sales per employee may have been achieved, at least in part, by increased use of contracting out by the enterprise.

The direction of the above results is consistent with the findings of the great majority of the studies undertaken, with the exception of the impact on employment. Some studies find employment in the privatised firm increases, while others find employment in the firm decreases. The impact of privatisation on employment in the firm depends on whether the sales of the divested firm increase rapidly enough after privatisation to offset the dramatically higher levels of per-worker productivity.

The one region where privatisation has not been judged to be particularly successful is the former Soviet Union. The privatisation process in the former Soviet Union republics took place during a period of extreme political and economic turbulence. Property rights were not secure, markets were extremely poorly regulated, and the privatisation process itself was often corrupt and saw 'insiders' (that is, incumbent management) and those with political connections capture the process and limit the gains from privatisation.[23]

The results of the above three survey articles, while compelling in terms of the *likely* overall benefits from privatisation, do not indicate that private ownership is *always* more efficient.[24] Some state enterprises can perform very well, at least for a period. Conversely, private companies can be inefficient and make mistakes.[25] But the balance of evidence, as summarised above, demonstrates that, *on average and over time*, the private sector is likely to be more efficient than the public sector in running commercial enterprises.

Furthermore, and independent of the performance of the privatised enterprise, privatisation has been found to enhance the effectiveness of competition. State-owned enterprises can act, either intentionally or unintentionally, to undermine competition in the markets they operate in. For example, the World Bank has found that SOEs are more likely than private firms to set prices below marginal costs, raise their competitors' costs through market or political methods and seek regulatory barriers to entry.[26] In addition, new entry is unlikely in a market that features a state-owned incumbent with a soft budget constraint, because the incumbent can credibly deter entry through predatory pricing. Privatisation may also make competition policy easier to implement. As the OECD notes, "The recent experience of OECD countries indeed abounds with examples of vertically-integrated public enterprises (sometimes sheltered from competition law provisions) which were found to abuse their dominant position in an upstream market to foreclose entry of new competitors in liberalised downstream markets".[27]

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23 Black *et al* (2000) note the lack of an adequate legal system, the absence of clearly defined property rights and the breakdown of central government authority that accompanied privatisation in the former Soviet Union.

24 As Easton notes, "compelling evidence on *inevitably* [my emphasis] superior performance by privatised companies does not exist". Brian Easton, 'A hubris of managers', *Listener*, 17 November 2001.

25 Berle and Means (1932) drew attention to the many weaknesses of the private sector corporate model. For a discussion of some of the ways capital markets mitigate these problems, see Jensen and Ruback (1983).

26 See, for example, Jones (1985) and World Bank (1995) for empirical evidence.

27 Gonenc *et al*, *op cit*, p 38.

The reasons why private businesses typically perform better than state-owned ones have been well documented. In brief, owners of private-sector companies have better incentives and a better ability than governments to monitor their companies' managers.[28] In the private sector, ownership is concentrated (relative to the public sector where all citizens are owners). As a result, private owners have a greater incentive than governments to monitor the performance of their managers, to improve corporate governance and to align the managers' interests with their own.[29] In the public sector, on the other hand, taxpayers (the ultimate owners of SOEs) have relatively little incentive to monitor the performance of SOEs. In addition, in comparison with SOEs, private firms typically have better defined and simpler objectives, with commercial objectives usually paramount. On the other hand, governments often find it difficult to resist intervening in SOEs for political ends.[30]

That is not, by any means, to argue that all activities should be privately owned. In many situations, public provision of a public good or service may well be preferable.[31] Examples include such activities as courts, defence, foreign policy and police. However, even in such cases, the private sector can play a useful role in some circumstances in providing aspects of the public good or service, as is discussed in section 8 below.[32, 33]

In summary, the effect of privatisation is probably one of the most exhaustively studied topics in empirical economic literature in recent years. The balance of evidence, as surveyed above, indicates that:

- private firms tend to be more efficient than their counterpart state-owned firms, especially in competitive industries; and
- privatisation of state-owned enterprises is likely to lead to improvements in the efficiency of the enterprises and to more open and competitive product markets, to the benefit of consumers, taxpayers and the economy as a whole.[34]

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28 Private sector monitoring can be far from perfect, as the collapse of Enron has highlighted. The issue, though, is in which system – public or private ownership – is the monitoring likely to be 'least worse' on average and over time.

29 As outlined by Alchian in 1965.

30 Shleifer and Vishny (1994) catalogue numerous cases of SOE inefficiency resulting from political interference. This waste usually takes the form of padded employment levels, above-market wages, investment in projects that benefit politicians rather than consumers and over-investment resulting from subsidised prices.

31 The definition of a 'public good' is a good where consumption is both 'non-rival' (that is, consumption by one person does not reduce the amount available for someone else) and 'non-excludable' (that is, where it is not possible to exclude effectively a non-paying customer).

32 For example, some aspects of defence and foreign affairs services, like routine supplies and services, and some aspects of maintenance can be and regularly are contracted out.

33 For a discussion of where to draw the line between public and private provision of public goods, see, for example, Hart *et al* (1997).

34 As Megginson and Netter, *op cit*, p 347, note, "the studies [covered in their survey] almost unanimously report increases in performance associated with privatisation … Privatisation appears to improve performance measured in many different ways, in many different countries".

The question of which assets the government should own and which the private sector should own can only be addressed on a case by case basis. But such decisions should take into account the experience of the last 20 years of the typically superior performance of private enterprises in supplying commercial goods and services and the net benefits that have been witnessed from privatisation of government-owned commercial businesses. That is not to deny that some public enterprises can perform well, at least for a period, or that some private enterprises can perform poorly. But, as Stigler noted, "… we must base public policy not upon signal triumphs or scandalous failures but upon the regular, average performance of the policy".[35] To ignore this decision rule is akin to smoking cigarettes: not all smokers die of smoking, but the odds are not favourable.

[35] Stigler (1975), p 185.

# 5

# EVIDENCE FROM NEW ZEALAND

The international evidence that privatisation works is compelling (refer section 4 above). But this still leaves the question of whether New Zealand may be different. Perhaps privatisation works in other countries but not in New Zealand?

From 1988 to 1999, New Zealand governments sold 30 major assets or enterprises (refer Annex 4). A total of around $19 billion was realised from these sales. Since 1999, no further major SOE sales have taken place.[36]

Several formal studies have examined the effects of privatisations in New Zealand. In particular:

- a study of the Telecom deregulation and sale found net gains of around $0.5 billion per annum (in 1987 prices) over the period 1987–1993 for the New Zealand economy.[37] Underlying the gains were large benefits to consumers (from significant declines in the price of phone services, reduced waiting times for services and increased access) and to Telecom (from increased productivity and output). While the general advances in telecommunications technology during the period were a contributing factor to these benefits, the authors note that the threat of competition resulting from the deregulated environment is likely to have encouraged Telecom to invest in new technologies;[38]
- a study of the privatisation of New Zealand Rail indicates the sale benefited the economy by between $0.9 billion and $9.8 billion in total over the ten years to 1997 (equivalent to up to 1 percent of annual GDP over the decade).[39] Consistent with the findings of many overseas studies, the New Zealand Rail study notes that a lot of the benefits were achieved in the lead-up to privatisation. Taxpayers were the primary beneficiaries from the sale because they avoided having to continue subsidising the

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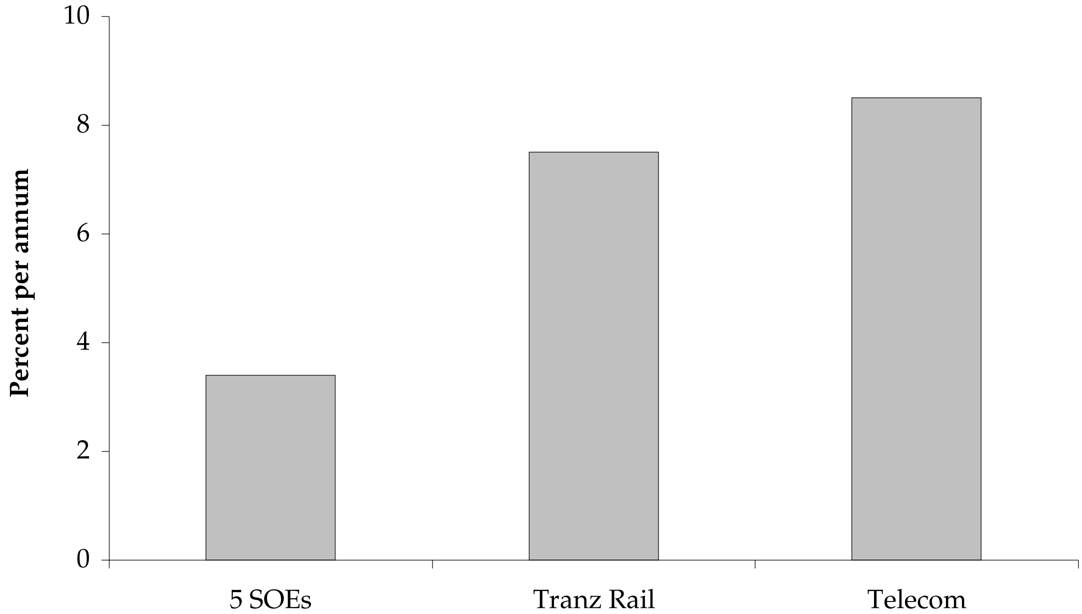
36 However, as noted in footnote 11 above, there have been ongoing asset-ownership transfers from the central government to the private sector in New Zealand.

37 Boles de Boer and Evans (1996). The study estimates the total net benefits since 1987 when deregulation of the telecommunications sector was announced. Data were not available for the period before 1987, thus precluding a comparison of the trends in costs and benefits since deregulation and privatisation (1990) with the trends in the period prior to deregulation and privatisation.

38 *Ibid*, p 25. For a discussion of the relationship between deregulation and rates of adoption of new technology, see Dixit and Pindyck (1994, ch 8).

39 New Zealand Institute for the Study of Competition and Regulation (NZISCR) (1999). The upper estimate is based on a comparison of the actual performance of New Zealand Rail following the decision to privatise with projections of the performance of New Zealand Rail had it remained in state ownership. While such projections are inevitably subjective, the approach used is, in principle, the most appropriate basis for evaluating policy reform and it is widely used in overseas studies of the impact of privatisation.

Figure 3: Comparative productivity performance




Note: the figures for four of the SOEs and Tranz Rail are for the period 1988 or 1989 to 1998. The figures for the other SOE relate to 1994 to 1998 and those for Telecom cover the period 1987 to 1993.

state-owned rail business (taxpayers had been subsidising New Zealand Rail since the 1930s);[40]

- a further study compared the performance of five SOEs with two privatised entities (Tranz Rail and Telecom New Zealand) during the decade to 1998.[41] None of the five SOEs achieved the productivity gains of either of the companies that had been sold (refer figure 3 above). The study also noted that the labour productivity (that is, output per employee) of the five SOEs typically increased following corporatisation and then declined, consistent with the findings of the World Bank (noted in section 6, question 7 below) that performance improvements in SOEs are difficult to "lock in"; and

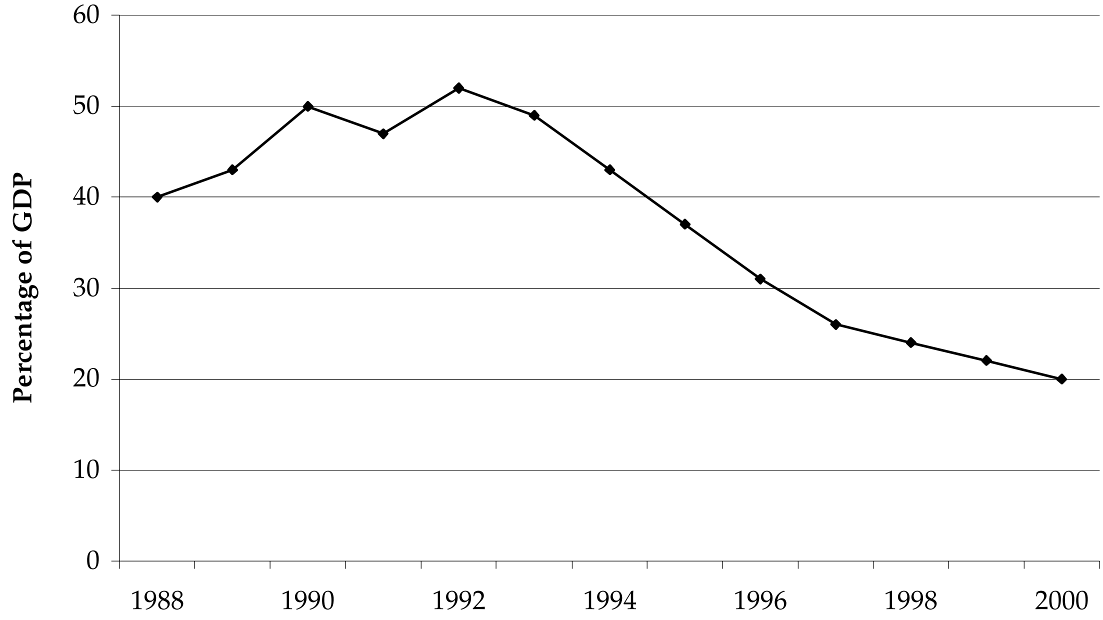
- in a broad-ranging review (undertaken in the early 1990s) of the corporatisation and privatisation process in New Zealand, Duncan and Bollard noted the government's objective of slowing and, if possible, reversing the growth in public debt was achieved.[42] Net public sector debt has fallen from a peak of over 50 percent of GDP in 1992 to under 20 percent currently (refer to figure 4 below), with proceeds from privatisation accounting for over half the decline.

40 The study notes that private investors in Tranz Rail earned an average 11 percent per annum return on their investment between the date of sale (1993) and 1998. While this average return of 11 percent per annum across all investors is in line with expected returns on other investments, the average return made by the initial investors was much higher and the average return made by public investors since Tranz Rail listed (1996) has been much lower (refer question 17 in section 6 below).

41 NZISCR (2000).

42 Duncan and Bollard (1992).

Figure 4: Net public debt as a percentage of GDP




However, as in other countries, not all privatised companies in New Zealand have succeeded. For example, after several years of successful operation post-privatisation, Air New Zealand failed spectacularly in 2001. The experience of Air New Zealand is considered in Case Study 1.

Overall, the results of the studies of New Zealand privatisations noted above are consistent with the general finding from other countries that privatisation 'works'. However, the pace of privatisation in New Zealand slowed drastically at the end of the 1990s and the current government has put a stop to further privatisations of SOEs. As noted above, New Zealand appears to be the only country in the OECD with a comprehensive ban on privatising SOEs.[43] The current halt to privatisation of SOEs in New Zealand is likely to reflect the concerns the public has had about privatisation. These concerns are addressed in the following section.

[43] Some OECD countries have restrictions on the degree of privatisation (that is, the percentage stake that could be sold), or sectors that could be privatised, or criteria by which the government might undertake privatisation.

## Case Study 1

## Air New Zealand Ltd partially renationalised

The financial collapse of Air New Zealand in 2001 has led to claims that "privatisation has failed" and that airlines need to be government owned. This is far from the case.

It is true that if Air New Zealand had remained government owned it would probably not have been allowed to make the purchase of Ansett Australia that underlay Air New Zealand's demise. But that is the nature of private enterprise. Sometimes companies get it right and sometimes they get it wrong. The case for privatisation is not based on the claim that private enterprise is somehow always right and public enterprise always wrong. Rather, it is a question of which form of ownership is likely to be most efficient over time.

The evidence is that airlines are no different from other businesses when it comes to the relative efficiency of public and private ownership. A comprehensive study by Ehrlich *et al* published in the *Journal of Political Economy* examined the relative efficiency over time of 23 state and privately owned international airlines.[1] The study found that state-owned airlines had lower productivity growth (by 1.6 to 2.0 percent per annum) and higher cost growth (by 1.7 to 1.9 percent per annum).

In 2001, the New Zealand government partially renationalised Air New Zealand by injecting $885 million for which the company issued new shares that amounted to 82 percent of the increased capital.[2] Governments in several countries provided financial support to airlines in the wake of the September 11 attacks in the United States and the subsequent downturn in air travel, but no other OECD country has effectively nationalised an airline. In Switzerland and Belgium the respective 'flag carriers', Swiss Air and Sabena, went bankrupt and new, privately owned companies were established, with government support taking the form of some financial guarantees and/or minority ownership.

The international trend in airlines, as in other commercial enterprises, is away from government ownership. In 1985, of the 611 airlines in the world, 234 (38 percent) were state owned. During the subsequent five years, governments announced plans to privatise 153 (65 percent) of the state-owned airlines and achieved their objective in a little over half these cases.[3] Now, of the major regions around the world, only in Eastern Europe, the Middle East and Africa does the state still dominate airline ownership.

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1 Ehrlich *et al* (1994).

2 A further $150 million has been set aside by the government as a possible capital injection for 2003. The government has stated it does not see itself as a long-term owner of Air New Zealand.

3 Source: International Civil Aviation Organisation (ICAO) Air Transport Bureau.

# 6

# TWENTY-SIX COMMON CONCERNS ABOUT PRIVATISATION

Despite the evidence from New Zealand and other countries that privatisation is generally beneficial, it remains a contentious subject. This section considers the main concerns that have been raised about privatisation in New Zealand.

## 1 Has the 'family silver' been given away?

Quite the opposite. First, in public ownership, much of the 'family silver' was in a bad state of repair. Businesses like the Bank of New Zealand, New Zealand Rail, New Zealand Steel, the Shipping Corporation, the State Coal Mines and Synfuels required millions of dollars of taxpayers' funds to keep them solvent. Jennings and Cameron note that "in 1985/86 the State Owned Enterprises managed assets valued at over $20 billion, but returned no net after tax cash to taxpayers".[44]

Secondly, the businesses were not given away. As noted in section 5, the Crown raised around $19 billion from the sales. Proceeds from the sales were a major factor permitting net public debt, as a percent of GDP, to be more than halved during the 1990s (see figure 4 above).

More fundamentally, even if SOEs are making money, it doesn't mean they should remain government owned. The key questions are whether the public or private sector will run the businesses more efficiently and whether ownership of the business is the most appropriate form of government intervention. As the evidence clearly demonstrates, the answers most often will be that private ownership is more efficient, and that there are better ways than owning commercial enterprises for the government to achieve its objectives.

## 2 Didn't the New Zealand government sell its assets too cheaply?

Almost all privatisations in New Zealand have been conducted through an open and competitive sales process with anyone in the world able to bid. There is no reason in such a sale process to believe that taxpayers have received less than full value for the

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44 Jennings and Cameron (1987), p 339.

Table 1: Listing day premia for government IPOs

| | *Public issue price $* | *Listing date* | *Listing day closing price $* | *Listing day premium %* |
|---|---|---|---|---|
| Auckland International Airport | 1.80 | 28 July 1998 | 2.05 | 14 |
| Capital Properties[1] | 0.50 | 27 November 1998 | 0.59 | 18 |
| Contact Energy | 3.10 | 11 May 1999 | 3.34 | 8 |
| Weighted Average[2] | | | | 10 |

[1] Instalment receipts. A second instalment of 57c (or 50c for initial subscribers) was payable on 30 June 2000.
[2] Weighted by the government's proceeds from the sale of shares to the public.
*Sources*: First New Zealand Capital, the New Zealand Stock Exchange and the Treasury.

assets at the time of the sale.[45, 46] If investors had seriously believed an asset was worth more at the time, they were free to bid for it.

It would be expected in a competitive asset sales process that actual (ex-post) returns from some sales will exceed market norms and returns from others will be below market norms, because the value of the assets changes over time.

It is generally difficult, if not impossible, to obtain objective information on the actual returns achieved by investors in the privatised companies because some of the assets were merged with other entities (for example, Postbank with ANZ), the companies have often been restructured once or several times and shares in almost all the privatised entities are not publicly traded (the exceptions are considered below). Anecdotal evidence, however, suggests that (as would be expected) there have been winners and losers amongst the buyers of the privatised assets. Returns on the bulk of the privatised financial institutions (like the Bank of New Zealand, Rural Bank, and Postbank) have almost certainly been above the market average return, even allowing for the riskiness of the investments, since risk-adjusted returns in the financial sector as a whole have been high. On the other hand, returns on the Forestry Corporation and other forestry cutting rights, New Zealand Steel and Timberlands have almost certainly been well below risk-adjusted market norms. The sale of the Forestry Corporation is considered in more detail in Case Study 2.

Even where the New Zealand government has sold shares in the businesses by way of a public float there is little evidence of systematic under-pricing by the government. In many countries, governments have tended, for political or other reasons, to under-price assets sold to the public by way of initial public offerings (IPOs). In New Zealand, the government has sold its shares in three companies – Auckland International Airport,

45 The possibility of a 'winner's curse' suggests that buyers may in fact tend to overpay for an asset in a competitive auction process.

46 Harrison and Grimes (1989) emphasise the importance of not restricting the list of possible buyers if the government is to get the best price, and in particular, given the small size of New Zealand's capital market, of ensuring the sales process is open to foreign bidders (p 122).

## Case Study 2

## Forestry Corporation of New Zealand Ltd

The Forestry Corporation of New Zealand (FCNZ) was formed as an SOE in the mid 1980s from large parts of the commercial forests of the former Forestry Department. The principal assets of FCNZ were forests, forest cutting rights and processing operations in the central North Island.

The Crown sold its shares in FCNZ in 1996 for NZ$1.6 billion. The shares were sold to the Central North Island Forest Partnership (CNI), a consortium of Fletcher Challenge Forests Division (37.5 percent partner), the Chinese-government-owned Citic[2] (37.5 percent) and Brierley Investments Ltd (25 percent). The government retained ownership of the land underlying the forests for future Treaty of Waitangi settlement purposes.

After the privatisation of FCNZ, international timber prices fell. Critically, prices for Douglas fir – wherein much of the early cashflow and assessed value of FCNZ was expected to lie – were well below expectations.

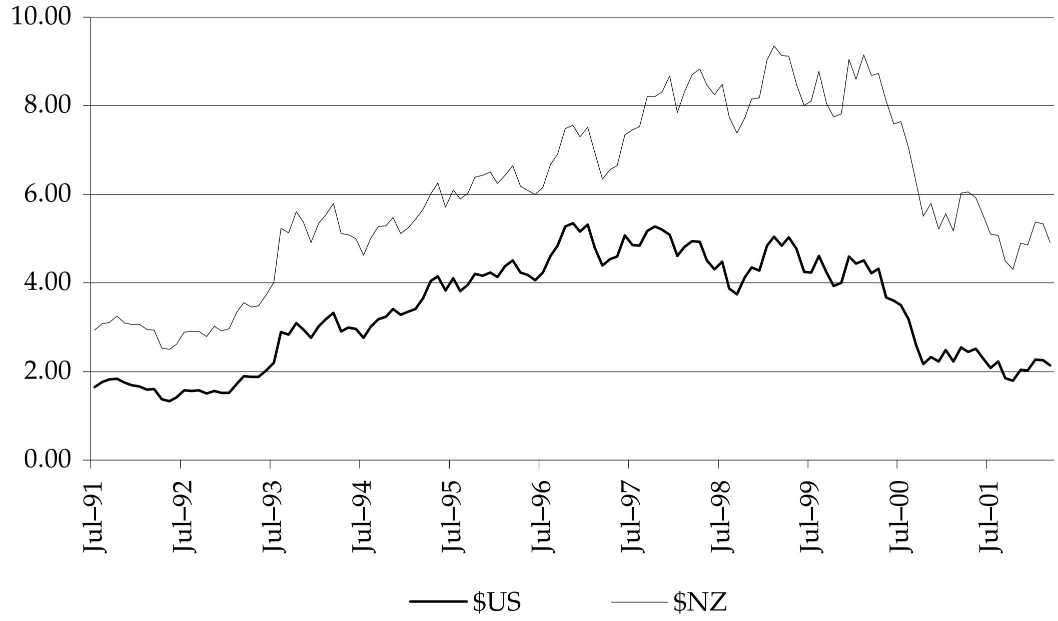
With the value of the investment falling, Brierleys negotiated an early exit and sold its stake to the other two consortium partners in 1998. The partnership continued to struggle, despite receiving further financial support (including additional equity and loans) from the two remaining partners. After several years of difficulties, CNI breached its external financial covenant ratios and was placed in receivership in 2001.

The FCNZ episode highlights the commercial risks the taxpayer can avoid by a well-managed privatisation. With the advantage of hindsight, the buyers of FCNZ clearly paid too much for the business, although at the time the transaction was undertaken at market value and the government was criticised by some for selling at too low a price.

With the downward path of international forestry prices, the CNI partners' equity was eventually written off, with severe consequences for the ultimate shareholders. Indeed, the purchase of FCNZ was a significant factor in the decline of Fletcher Challenge Ltd, once New Zealand's largest company. From the taxpayers' point of view, however, the sale was a success. The government was able to retire $1.6 billion of debt and avoid the commercial risks associated with owning a major forestry business.

1 Citic held its shares in the CNI consortium through its subsidiary Citifor Inc.

Figure 5: Telecom New Zealand share price: 1991–2001




*Source*: Telecom New Zealand.

Capital Properties and Contact Energy – by way of IPOs.[47] Investors in these floats achieved, on average, a risk-adjusted premium on the listing day of 10 percent (refer table 1 above). This 'IPO premium' is only 1 percentage point above the average listing day premium on private sector IPOs in New Zealand of 9 percent[48] but is well below the premium typically seen in government floats in other countries of around 34 percent.[49]

## 3 What about Telecom? Surely the government sold its shares in Telecom too cheaply?

At the time of the sale (1990), the proceeds the government received for its shares in Telecom of $4,250 million were widely seen as high and as a positive surprise to the market. However, the claim that the government sold its shares too cheaply became common in the mid-to-late 1990s when Telecom's share price was at historical highs. Since the re-rating of international telecom stocks in the early 2000s and the move to more intensive regulation of Telecom New Zealand, the claim that the government sold the shares too cheaply is heard much less frequently.

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47 The other privatised companies that are listed on the Stock Exchange – Air New Zealand, Tranz Rail and Telecom – were sold by the government to trade buyers who were subsequently required to list the companies. Contact Energy was sold by the government partially to a strategic investor and partially by way of a public float.

48 Weighted average listing day premium for all IPOs in New Zealand since 1990. Source: JP Morgan.

49 Jones *et al* (1999) examine 630 privatisations by share float in 59 countries; they find the mean level of under-pricing for government initial public offerings is 34.1 percent (median 12.4 percent), well above the level of under-pricing that is normal for private sector IPOs.

The volatility of global telecommunication shares and the large decline in the values of telecommunication shares since 2000 highlight the risks investors in telecommunications companies are exposed to. Foreigners investing in New Zealand are exposed to the additional risk of fluctuations in the value of the NZ dollar, although they can hedge against this risk. In unhedged US dollar terms, with the decline in the NZ dollar over the period, the value of Telecom shares is now little above the price they first listed at (see figure 5).

When allowance is made for the dividends and capital repayments investors have received from Telecom during the period (1991–2001), the gross NZ dollar return on Telecom since its listing in July 1991 has been around 13 percent per annum (pre-tax). This compares with the average gross return from the NZSE40 of 10 percent per annum over the same period. The gross return on Telecom in US dollars has been around 11 percent per annum.

## 4 Hasn't privatisation led to more foreign control over New Zealand?

No. First, privatisation does not lead to a change in net claims by foreigners over New Zealanders. Rather, privatisation changes the mix of foreign liabilities, with the proceeds of any investment by foreigners being used effectively to repay foreign debt.

Secondly, regardless of whom the shares are sold to, the assets stay in New Zealand, as do the jobs and the government's sovereign powers to tax and regulate.

Further, there are very good reasons for allowing foreigners to participate in the sale process. The number of (potential) bidders is increased, thus increasing the likely sale proceeds for the taxpayer. In addition, foreign ownership facilitates the transfer of international industry-specific expertise to the domestic firm. This transfer will in turn also increase the expected revenue raised from the sale (in a widely marketed sale, the purchase price will reflect fully the discounted expected cash flows)[50] and the expected efficiency of the firm. Potential ownership by foreign companies also broadens the pool from which managers can be selected. Listing the firm in foreign share markets may also offer some advantages through increased monitoring, potentially extended information disclosure requirements and a 'deeper' market for the shares.

Finally, it is not the case that all the Crown assets have been sold to foreigners. Analysis of the residency of the buyers of assets (refer Annex 4) shows that around two-thirds of the assets (by number and value) were sold to combinations of foreign and domestic owners and around one-third to predominantly (that is, over 75 percent foreign-owned) or solely foreign-owned concerns.

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50 As long as property rights are expected to be secure: refer to Maskin (1992).

## 5 Hasn't New Zealand lost out from the huge sums of money sent overseas in dividends by the former SOEs? Hasn't privatisation been a significant factor behind New Zealand's large current account deficit?

Some observers point to the dividends being paid to foreign owners by former SOEs as 'proof' that privatisation has increased New Zealand's current account deficit. But privatisation is not to blame for the deficit.

With a floating exchange rate, when a foreigner buys NZ$1 of New Zealand assets, they must exchange it for a NZ$1 claim on foreign assets. The net claims on New Zealand from the rest of the world are unchanged. It is only if subsequent returns on the New Zealand or foreign assets are different from those expected at the time of the sale that there will be a (positive or negative) effect on the current account. Returns on individual investments by foreigners in New Zealand and by New Zealanders offshore will, in some cases, have exceeded average market returns and in other cases they will have been below average market returns. But, as noted in response to question 2 above, there is no reason to expect that the returns on investments in privatised assets in New Zealand will have systematically been above average market returns.

As noted in response to question 4 above, privatisation did not increase (or decrease) the country's net foreign liabilities. If the assets had not been privatised, it is true that there would be less dividends going offshore, but there would also be more interest payments going offshore as New Zealand's overseas debt would be commensurably higher. The overall effect on the current account would be very similar.

## 6 Many government businesses supply basic goods and services, such as electricity, water and postal services. Doesn't the government need to control such 'strategically important assets'?

Governments at various times have defined certain assets as 'strategic'. However, what is deemed strategic is very arbitrary: isn't food, for example, every bit as strategic as water? Further, the problem or problems the government is seeking to address by owning so-called 'strategic' businesses is rarely well defined. If the business is characterised by a significant market failure, some form of government intervention may well be justified. However, interventions other than ownership are likely to be preferable. For example, if excessive market power is the problem, then appropriate regulation should be applied. If externalities (that is, side-effects that impose costs or benefits on third parties) are the problem, then some form of tax or government subsidy may be appropriate. Rarely is government ownership of commercial business likely to be the best form of intervention.

Parliament's power to tax and regulate is not impeded in any way by privatisation. If anything, privatisation can enhance the government's ability to regulate a sector effectively because of the conflicts of interest that arise when the government is both regulator of a sector and owner of one of the commercial businesses in the sector.

Development of the transport sector in New Zealand, for example, was impeded for several decades as successive governments sought to protect the state-owned railways from competition from lower cost, long distance road-freight operators.

In summary, as the last century has shown, government ownership of businesses imposes many costs on society and offers few, if any, benefits that cannot be achieved by other forms of government intervention. And, as a large and growing number of countries now recognise, state ownership of infrastructure assets is not necessary for, and in fact may well hinder, economic development.

## 7 Can't SOEs be made to run efficiently?

Some gains can be made, at least for a time, from reforming state enterprises without full privatisation. But the World Bank, the world leader in advising on public sector reforms, is clear on its experience of the likely long-term effectiveness of attempts to reform public enterprise without privatising them. The Bank states:

> The World Bank's position on (the desirability of privatisation) is derived from long experience with failed attempts at reforming public enterprise. For years, the Bank supported efforts of governments to improve public enterprise performance but with little success. The efforts either did not bring the desired results or the improvements were not sustained.
>
> The costs have been high. In many countries, inefficient but privileged public enterprise drained budgets, diverted resources from health and education, seriously damaged the health of the banking sector and created obstacles for the development of the private sector. Observing the immense difficulties of reforming public enterprise without changing ownership, the Bank emphasises divestiture as a means of locking in the gains from reforms.[51]

The concerns expressed by the World Bank do not apply only to developing countries. In New Zealand, similar difficulties in locking in the gains from state enterprise reform efforts have been evident. New Zealand Rail is one example: starting in the 1880s, New Zealand Rail had five episodes of reform and different corporate-like structures under state ownership. With each reform attempt, the commercial performance of the rail business tended to improve temporarily but the improvement was not sustained and New Zealand Rail continued to make financial losses.[52]

More recently, while the SOE 'model' in New Zealand was lauded as being world-class when it was introduced in the mid 1980s, the commercial focus of SOEs in New Zealand is now being eroded. For example, a former SOE, Television New Zealand (TVNZ), is being restructured as a crown-owned entity (COE) and is to have non-commercial objectives imposed upon it. The value of the taxpayers' investment in TVNZ has been reduced as a result. Similarly, New Zealand Post has been subject to political sponsoring

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51 http://www.worldbank.org/html/fpd/privatesector/priv-ent.htm. Majumdar (1996) similarly finds that state sector efficiency improves during 'efficiency drives' but declines thereafter.

52 Orr (1981).

of its start-up retail bank, Kiwibank. While New Zealand Post promoted Kiwibank on commercial grounds, it is doubtful whether approval would have been given for the investment without the political backing of the deputy prime minister and the Alliance Party.[53] It seems to be an inevitable result of public ownership that political objectives reassert themselves over time.[54]

## 8 Isn't it mainly about getting the right people in the job, regardless of who owns the company?

As evidenced by the answer to question 7 above, the quality of the people is not the issue. Over time, what matters are the incentives, including those associated with private ownership, that people operate under. Take, for example, the relative performance of the West and East German economies: the 'people' were the same, but they were operating under markedly different systems. In Berlin, publicly produced Trabrants were ten times less saleable and more polluting than Volkswagens produced privately by other Germans a short distance away.

## 9 With assets such as New Zealand Rail and the Bank of New Zealand sold, hasn't the government lost the ability to use those assets to help meet wider social, environmental and economic goals?

Some people accept that private enterprise is likely to be more efficient but they still support public ownership as a way for the government to achieve its social goals. However, as Shleifer notes, "a good government that wants to further 'social goals' would rarely own producers to meet its objectives".[55] There are other, much better, ways for governments to achieve their social goals than owning business enterprises.

State ownership of commercial enterprises often ends up benefiting a privileged few (the management and employees of the enterprise) at the expense of the rest of society. And it often penalises, rather than helps, those on low incomes, because they end up paying higher prices or higher taxes to compensate for the inefficiency of the state enterprise.

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53 This highlights a further tension in the SOE model: that between SOEs, which naturally wish to expand the scale and scope of their business, and the extent to which taxpayers' money should be put at risk in new commercial ventures, such as the $107 million investment by Meridian Energy in power stations in Australia and the operations of New Zealand Post in Africa.

54 The OECD in its 2002 survey of New Zealand noted that the Kiwibank investment does not attempt to fulfil any public policy need: for example, it will not materially increase access to banking services in small towns because only nine out of 300 branches will be in areas that do not have a nearby bank (OECD, 2002, p 43). More generally, the OECD commented adversely on the New Zealand government's investments in Air New Zealand, Kiwibank and part of Auckland's rail infrastructure and recommended that the privatisation process be resumed (OECD, 2002, pp 3 and 109). Similarly, the International Energy Agency's 2001 review of New Zealand's energy policies called on the New Zealand government to "consider privatising remaining government interest in the electricity sector … and … review the rationale for government shareholding in the coal industry" (IEA (2001)).

55 Shleifer (1998).

The World Bank has considered the distributional impact of privatisation. The Bank concludes that "privatisation accompanied by rigorous opening up to competition and effective and independent regulation is more likely (than state ownership) to bring benefits to the poor – both generally through broad benefits to the economy and directly through access to better, less expensive services'.[56]

## 10 Didn't privatisation lead to massive job losses?

Many jobs were lost in New Zealand as the old state departments were commercialised and privatised. But the jobs lost were not viable ones: rather, they were, in effect, highly expensive welfare benefits. While unnecessary jobs were being propped up in the old state trading departments, other jobs were lost elsewhere, particularly in export industries that had to purchase overpriced goods and services from the state trading entities. More importantly, total employment in the New Zealand economy has grown by 334,000 (22 percent) since 1988 when privatisation began.[57]

## 11 Well, take Telecom: didn't workers bear the brunt of the adjustment? Haven't any gains been achieved by cost cutting and sustained attacks on staff numbers and conditions of work?

Telecom reduced its staff numbers drastically following deregulation and privatisation. But the initial job losses for employees of the former SOE were offset to some extent by increased employment in the wider telecommunications sector in New Zealand as Telecom contracted out services that were previously done in-house and as new companies entered the market. Further, as noted in question 10 above, total employment in the economy as a whole has grown by 22 percent since 1988.

As noted in section 4, employment in the privatised entity sometimes rises and sometimes falls post-privatisation. While privatisation almost invariably leads to productivity improvements (thus leading to reduced numbers employed for a given level of output), the sales of the privatised companies often increase even faster than the increase in productivity, resulting in an overall increase in the number of staff the company employs.

## 12 Hasn't privatisation led to asset stripping and reduced investment in infrastructure? Take New Zealand Rail for example.

The evidence indicates that privatisation usually leads to more investment by the company, rather than less. On average, investment rose by around 35 percent for the 211 privatised firms covered by the studies summarised in Annex 3.

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56 http://rru.worldbank.org/hot_topics_nelis.asp.

57 Full-time equivalent jobs. Source: *Household Labour Force Survey*, Statistics New Zealand.

In the case of Tranz Rail, claims that the company is 'under-investing' are disputed by the company, which notes that its capital investment has averaged $100 million per annum over the last eight years (compared with average depreciation of $35 million per annum). The investment has included over 200 kilometres of track replacement, new freight and marshalling facilities, an upgraded locomotive fleet and a new ferry, the Aratere (the first since 1983).[58] However, it should be noted that these figures relate to gross investment (Tranz Rail has also been selling assets during the period) and that investment by Tranz Rail has declined in recent years. From the perspective of the economy as a whole, more investment in rail is not necessarily a good thing; if the investment is not expected to achieve an economic rate of return, the resources would be better invested elsewhere.[59]

## 13 Privatisation may improve the financial performance of the firm. But what about the broader social impact of the restructuring? In particular, what happens to the workers that have been laid off by the privatised firm?

Relatively few empirical studies have addressed these broader social questions. One study that did was the extensive investigation supported by the World Bank noted in section 4.[60] The study found that after privatisation, consumers and workers overall were better off in 11 of the 12 cases examined (refer to figure 2 and footnote 21). This was despite layoffs and consumer price increases. The World Bank found that the losses to laid-off workers were compensated by severance pay and were outweighed from the point of view of the economy as a whole by the gains from stock shares and higher pay for those who kept their jobs. The losses to consumers from higher prices were considerably smaller than the benefits consumers received from expanded and better service.

Further, as noted in question 10 above, it is not at all clear why overstaffing of SOEs should promote economic welfare or overall employment. Rather, it is likely that the excessive costs of overstaffing in SOEs raises costs (and therefore discourages employment) elsewhere in the economy, in particular in the internationally competitive industries.

## 14 Didn't privatisation just allow 'greedy businesses' to get their hands on monopoly assets?

The great majority of state-owned businesses are not monopolies. In its briefing to the government in 1996, the Treasury identified only two of the then 15 SOEs as monopolies.

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58 'Tracking down the truth', *New Zealand Herald*, 22 November 2001.

59 A calculation of the rate of return to the economy as a whole from investment in rail would need to take into account the extent to which prices for other forms of transport (such as road freight) differ from their full economic cost.

60 Galal *et al*, *op cit*.

The two identified monopolies were Transpower and parts of the Airways Corporation. The rest of the SOEs operate in competitive or potentially competitive markets.[61]

Where monopoly power is an issue, the government should remove barriers to competition and apply appropriate regulation. There is argument in the theoretical literature as to whether government ownership of monopolies is preferable to appropriate regulation of a private monopoly. However, as Shirley and Walsh note, "the empirical literature is less ambiguous, finding that private regulated firms perform the same as or better than SOEs in most studies".[62]

Further, as noted in section 4 above, state ownership of commercial enterprises can create monopolistic positions and undermine the operation of competition, as politicians seek to protect the SOE and as the SOEs use the deep pockets of the state to enhance their market position.

## 15 Surely prices must go up with privatisation because privatised businesses have to pay dividends and taxes?

This view is often heard, especially in debates over the role of local governments in owning such commercial businesses as airports, ports and power companies. However, the reality in New Zealand is that privatisation and deregulation have often seen prices fall rather than rise (see, for example, question 18). While privatised businesses may have to pay more in the way of dividends and taxes, they also have greater incentives to minimise costs, thus permitting lower final output prices overall. Where prices have gone up following privatisation, this has often been due to the removal of cross subsidies, for example between households and businesses. And even here, because costs to businesses have come down, households benefit from the reductions in the price of business inputs into all the other goods and services they consume.

Further, from an overall economic perspective, it is desirable that all businesses are subject to taxation, so that the distortions the tax system imposes on business decisions are minimised. Similarly, SOEs should aim to make a return on their capital comparable with their private sector counterparts, so that SOEs face the full opportunity cost of the resources they employ. Society benefits from 'efficient' prices because such prices guide resources to their most valued uses. Higher prices may be required if prices have been artificially suppressed under state ownership.

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61 Since 1996, Asure New Zealand Ltd, the state-owned provider of meat inspection services, has been established as an SOE. Asure has a dominant position because European Union and United States regulations require such services to be provided by a state-owned entity.

62 Shirley and Walsh (2000), p 14. Of the studies surveyed, 12 examined the post-privatisation performance of firms in industries with limited or varying levels of competition; seven of these studies showed improved performance while five showed little change. Two of these five studies had sample sizes of one, however, and should be treated with caution.

## 16 Hasn't privatisation worsened the government's fiscal position? Haven't taxes or rates had to go up as the government no longer receives dividends from the privatised enterprise?

While a government loses a potential dividend stream with an asset sale, it also loses a debt servicing obligation if the proceeds from the sale are used to repay debt. Thus, it does not follow at all that the government's fiscal position will deteriorate. In fact, the fiscal position may well improve, to the extent that the government, as seller, captures in the sale price some of the likely efficiency gains resulting from privatisation.

In New Zealand the proceeds of the government's assets sales were used to repay Crown debt. Thus, the Crown's balance sheet was strengthened, not weakened, by the asset sales: that is, the Crown's debt-to-equity ratio was reduced. As illustrated in figure 4, as a result of privatisation and fiscal surpluses the Crown's net debt has fallen dramatically over the last decade. Lower debt has meant interest costs are lower than they would otherwise have been.[63]

## 17 Large shareholders may have benefited from privatisation but what about the small shareholder?

Sometimes large investors have done well from privatisation and sometimes they have fared disastrously (refer question 2 above).

Brian Gaynor notes that large investors fared well in the case of Tranz Rail,[64] although company chairman, Bob Wheeler, notes that much of the gain made by the large investors was achieved before Tranz Rail was listed publicly.[65] More generally, it can be argued that large shareholders add expertise and are necessary to lead the restructuring that is needed in former SOEs.

Small investors have made above-market returns in many countries when the government has sold its shares in a company by way of a public float (see question 2).

## 18 Shareholders may have benefited from privatisation but what about the customers?

As noted in section 4, privatisation enhances the competitiveness of the markets that the former SOE operates in, to the benefit of consumers and the economy as a whole, by removing the tendency for governments to favour the state enterprise. Relatively few

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63 Rather than declining, the Crown's net worth has increased since 1993 (the first year data is available), from negative $7.7 billion to positive $11.5 billion at June 31 2001 as a result of operating surpluses and net asset revaluations. Despite the asset sales over the period, the government's total assets have increased from $52.2 billion at 31 June 1993 to $65.1 billion at 31 June 2001. Source: Crown Financial Statements.

64 See, for example, 'Privatisation leaves public behind', by Brian Gaynor, *New Zealand Herald*, 20 March 2002.

65 'Tracking down the truth', *New Zealand Herald*, 22 November 2001.

studies, however, have directly examined the impact of privatisation on the consumer. One study in New Zealand that did examined the impact on customers of the 1987 deregulation and 1990 privatisation of Telecom New Zealand.[66] The study documents significant declines in the price of phone services: toll charges fell on average by 55 percent and local rental charges did not go up in real terms. Further, the quality and levels of service improved: in 1987 there were 15,000 people waiting to have phones connected; by 1996 waiting periods had been virtually eliminated. Directory assistance enquiries in 1996 were answered within 20–30 seconds instead of up to 20 minutes. Businesses enjoyed a similar improvement in customer responsiveness.

## 19 Isn't New Zealand too small and isolated to leave it all to the private sector? Doesn't the government need to be a player in the market to keep the multinationals honest?

No. New Zealand's small size is in fact a further reason why the government should not own commercial enterprises. Government ownership of enterprises like Airways, New Zealand Post and TVNZ restricts the access of these companies to equity capital markets and impedes their ability to enter strategic alliances with major international operators. New Zealand should see itself as part of the world and be open to the best skills and technology the world can offer. New Zealanders can be part of the biggest firms in the world and still work and live in New Zealand.

'Keeping the competition honest' is not a sustainable reason for state ownership. As noted in section 4, if anything state ownership tends to cripple markets rather than make them operate better. 'Keeping the competition honest' was often cited as the rationale for the Australian government owning Medibank Private, the state-owned health fund. However, while Medibank undercut its rivals initially, it ran into financial difficulties as a result and had to seek a 13 percent increase in premiums last year. The government allowed a 9 percent increase and has since decided to commission a study into the sale of the health insurer.[67]

A government decision to remove itself from owning commercial businesses, however, is not by any means the same as a government decision to 'leave it all to the private sector'. The government has many key roles to play in the New Zealand economy, including setting and enforcing the rules under which businesses operate through competition policy, trade policy, the industrial relations regime and capital markets regulation. There is no evidence to suggest that having the government own commercial businesses would benefit New Zealand or any other small or isolated country.

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[66] Boles de Boer and Evans, *op cit*.

[67] 'Medibank stirs healthy debate', *Australian Financial Review*, 6 May 2002.

## 20 Wouldn't it have been better if the government had privatised the assets gradually, like the Australian government is doing with the telecommunications company Telstra, rather than selling the companies in one 'king-hit'?

As is discussed further in section 8, partial privatisation can have advantages over full state ownership, at least for a period. As has been seen with companies like Auckland International Airport and Ports of Auckland, listing an SOE on the stock exchange can increase the available information on the organisation's performance and enhance the monitoring of the company. However, the evidence indicates that partial privatisation needs to be followed by full privatisation over time if the benefits, in terms of improved performance, are to be sustained (refer section 8).

Telstra illustrates some of the problems that can arise with partial privatisation. The Australian government's continued shareholding in Telstra has left the Australian taxpayer exposed to the risks of owning a telecommunications company. With the decline in Telstra's share price over the last 12 months, the value of the Australian taxpayers' shareholding has fallen by A$12.8 billion.[68] Further, continued state ownership has left Telstra open to ongoing political interference through the government's interest as the dominant shareholder and may act as a disincentive for competitors to enter the market, given the implicit government guarantee that Telstra enjoys.

## 21 Privatisation is no longer a big issue in New Zealand: hasn't everything been sold?

State-owned enterprises are still a major component of the New Zealand economy, Statistics New Zealand figures indicate that in 1997 (the latest date for which figures are available) government trading enterprises (central and local government) accounted for around 4.4 percent of GDP and 5.6 percent of gross investment.[69] This share is probably comparable with the average for OECD countries.[70] However, as the OECD has noted, given the natural disadvantages the country faces due to its location and relative lack of natural resources, New Zealand needs to do better than average in its policy settings if it is to prosper.[71]

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68 'Adsteam out of puff', *Australian Financial Review*, 3 May 2002.

69 Statistics New Zealand: New Zealand Institutional Sector Accounts, 1987–1998. Excluded from the Statistics New Zealand definition of "government trading enterprises" are many commercial or potentially commercial government businesses, including the Accident Compensation Corporation (ACC), Housing New Zealand, the Crown Research Institutes (CRIs), the state highways and local government roads and water supply. Since 1997 the central government has received around $3 billion in proceeds from asset sales, including from the sales of its shares in Contact Energy Ltd and Auckland International Airport Ltd (refer Annex 4).

70 Megginson and Netter, *op cit*, estimate that the SOE share of industrialised-country GDP is now probably below 5 percent, p 327.

71 OECD (2002), p 14.

The central government still owns many businesses in New Zealand, including three major electricity generators and retailers, an electricity transmission business, a coal company, the dominant postal service and a start-up retail bank (New Zealand Post), the largest residential landlord (Housing New Zealand) and a majority stake in a major airline.[72] In contrast, in Australia the federal government plans to sell its remaining shares in Telstra and is commissioning a scoping study of the sale of Medibank Private, Australia's largest health insurer and one of the few remaining major businesses it owns.[73]

In addition, local government in New Zealand continues to own a variety of commercial businesses. A recent central government consultation document puts the assets of the local government sector at $46 billion.[74] The investment by local government in water supply and wastewater assets alone is of the order of $6 billion, larger than the total investment in Telecom's network. Local government also has major investments in airports, commercial property, forestry, ports, power companies, roads and a variety of other assets.

As noted above, the World Bank estimated in its study of the economic impact of privatisation that privatisation increased net welfare by around 26 percent of the firm's pre-divestiture sales on average.[75] A similar gain in performance from privatising New Zealand's SOEs would increase New Zealand's welfare by over $1 billion per annum, or around 1 percent of annual GDP. This estimate makes no allowance for the gains that would be expected from privatising the commercial COEs and local government trading enterprises.

## 22 Won't the government just waste the proceeds from its privatisations?

As noted above (question 16), successive New Zealand governments have used the proceeds of privatisation to repay debt.[76] In other countries this has not always been the

72 At 30 June 2001, the New Zealand central government owned 16 SOEs with assets with a book value of around $10.6 billion, a range of quasi-commercial COEs (refer Annex 5) and other potentially commercial assets (for example, the state highways ($11 billion) and student loans ($4 billion)). The total book value of the assets of state enterprises will now be higher with the purchase by the central government of 82 percent of Air New Zealand ($885 million), the purchase of the lease and assets of the Auckland rail corridor ($81 million) and the purchase of parts of the retail electricity sector (with the reported $139 million spent by SOEs Meridian Energy and Genesis for On Energy's electricity customers).

73 Australian Federal Budget 2002. The federal government will need the support of the Democrats (previously not forthcoming) in the Senate to achieve further asset sales.

74 *Review of the Local Government Act 1974: Have Your Say* (2001), Consultation Document, Department of Internal Affairs, Wellington.

75 Galal *et al*, *op cit*.

76 The government's net debt increased from 1988 to 1992 despite the privatisation programme as a result of large operating deficits. The use of the proceeds of privatisations to repay debt resulted in the increase in public net debt being lower than it would otherwise have been.

case, but the International Monetary Fund (IMF) considers that the proceeds from privatisation are generally saved by governments and not used to increase government spending.[77] If the proceeds of asset sales are used in part or in full to finance increased government spending, the key test is that the benefits of the increased spending exceed the costs of raising alternative sources of funds, including the deadweight costs of taxation.

## 23 If shares in state or local government enterprises are given directly to people, won't many of them just sell the shares and waste the money?

People are free to spend their net earnings and manage their other assets as they see fit. It is not clear why shares they receive in government enterprises should be any different. Some people would sell the shares and use the money to achieve their goals. Others would choose to hold the shares and reap the benefits over time, and others again would choose to sell their shares because they have better and more pressing uses for their money.

## 24 Why should the current generation get the proceeds from privatisation? Past generations have invested in them. Don't the assets belong to the community?

The situation with privatisation of government assets is, in this respect, no different from the demutualisations of insurance companies like AMP and others. There were few complaints when ownership of these former mutual companies was crystallised in their existing policy holders. Further, current generations are not the only ones who benefit from privatisation. Both current and future generations can be expected to benefit from the increased efficiency and reduced debt that often follows privatisation.

## 25 What about the impact on the environment? Don't governments have a duty to protect the environment?

Governments and private individuals have a role in protecting the environment. It is doubtful though whether state ownership of businesses helps protect the environment. In fact, the opposite may be the case: severe environmental damage has occurred, particularly in eastern Europe, as a result of the distorted incentives facing managers of state enterprises. In New Zealand, when the New Zealand Electricity Department focused more on employment creation than earning an adequate return on its capital, unnecessary dams were built with accompanying environmental damage. Similarly, much backcountry native forest in New Zealand was cleared by state-owned enterprises that were not required to make an economic rate of return on their activities. The 'Think Big' projects of the Muldoon government provide a further example.

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[77] Davis *et al* (2000).

Recent research indicates that SOEs tend to pollute more than private firms. A four-country survey of pulp mills in Thailand, Bangladesh, India and Indonesia showed that the state-owned plants made far less effort to abate pollution than their private counterparts.[78] As the World Bank has noted, assigning private property rights to resources is a more effective environmental strategy than nationalising them in the name of conservation.[79]

## 26 Hasn't privatisation failed in New Zealand? Look at the collapse of Air New Zealand and the losses being made by Tranz Rail.

Privatisation certainly hasn't failed in New Zealand. As noted in section 4, the evidence indicates that privatisation has regularly brought large benefits to taxpayers, consumers and the economy as a whole in New Zealand, as it has in other countries.

That some of the 30 major privatised enterprises have lost money or failed is hardly surprising. As noted in Case Study 1 on Air New Zealand, it is a normal part of a dynamic economy that some businesses fail. In the case of Tranz Rail, the relevant questions are not whether Tranz Rail has been in financial difficulties but:

- how much more or less would Tranz Rail have lost under continued state ownership. The New Zealand Institute for the Study of Competition and Regulation (NZISCR) study noted in section 5 suggests that Tranz Rail would have continued to lose much more money under state ownership; and
- how much more efficient the transport sector is in New Zealand now that the government is not seeking to protect a state-owned transporter but has instead allowed air, road and sea-freight operators to compete with a privately owned rail business.

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78 Hartman, Huq and Wheeler (1997).

79 Cited in New Zealand Business Roundtable (1992), p vii.

# 7

# WHEN DOES PRIVATISATION WORK BEST?

Most of the concerns raised about privatisation can and should be dispelled by an objective appraisal of the evidence. That is not to say, however, that privatisation has always worked or that the process has always been well run. This section considers what has been learnt from 20 years of experience about how best to run a privatisation process and when privatisation works best.[80]

For privatisation to produce substantial and enduring results it has to be done right. And the government's role is critical.

In particular, experience indicates that privatisation works best when the government:

- deregulates before privatising. Deregulation may result in less money for the government from the sale[81] but, more importantly, it means the economy as a whole benefits because competition keeps the privatised firm 'honest'. Low-income earners, in particular, will benefit from having access to better quality goods and services at lower prices;
- establishes and maintains a sound regulatory environment;
- recognises that privatisation does not work well for some types of goods and services. In particular, for public goods or services where quality is hard to measure, and if private firms do not bear the reputational impact of their actions, it may well be better for the government to produce the goods or services in-house (refer section 8);
- conducts privatisations in a fair and transparent manner. Again, the economy as a whole and those on low incomes are likely to be better off from a fair and transparent process. Otherwise, the risk is that the benefits of the privatisation are captured by a small elite;
- opens the sale process to the broadest possible cross-section of potential buyers (including foreigners);[82]
- ensures resources from privatisation sales are put to productive uses; and

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80 Refer, for example, to World Bank (1992) and (1995a).

81 However, if deregulation is expected to increase market growth or if the bidder brings superior technology, deregulation may secure the government a higher price from the privatisation.

82 Megginson and Netter, *op cit*, p 360, note that one of the significant and consistent relationships found in their survey is that "foreign ownership, where allowed, is associated with greater post-privatisation improvement ...".

- manages the inevitable political and social tensions that arise as privatisation occurs and, in particular, the critical issues of foreign ownership and worker redundancies.

Whether the shares of a company should be sold by way of a public float (where shares in the company are sold to the public and traded on the stock exchange) or by way of a trade sale (where the shares are sold to a single buyer) will depend on the nature of the asset and the government's objectives from the sale. In general, a trade sale is likely to yield the highest returns (because the government captures the 'control premium'). However, the best form of any sale should be decided on a case by case basis.

A conventional sale of the business is, in fact, not even necessary to get most of the benefits of privatisation. Giving away the shares in the business to all the country's citizens (or to local ratepayers or consumers, as is appropriate) is an option. A share give-away may reduce public unease with privatisation and is likely to be preferable, from both an efficiency and equity perspective, to continued state ownership. However, the company may experience relatively weak corporate governance and monitoring while its shareholding is highly diffuse. A share give-away also raises implementation issues about who gets how many shares. However, these issues are resolvable – as the share give-aways of some energy trusts in New Zealand demonstrate.

# 8

# PUBLIC–PRIVATE PARTNERSHIPS

Another trend in recent years has been the growing use of public–private partnerships (PPPs). Such partnerships are particularly common in the United Kingdom, United States and Australia, and increasingly in Europe and South America, but they have been rarely used to date in New Zealand.[83]

Public–private partnerships can take many different forms and mean different things in different countries. The principal forms of PPP include:

- joint public and private sector ownership of a business (for example, following partial privatisation of a former state-owned enterprise);
- private provision of publicly funded services (for example, ‘contracting out’ of health or childcare services); and
- private funding of what have traditionally been ‘public services’ (for example, privately financed roads) with the service then either leased back by the state or paid for by private customers.

Given the marked differences between these principal forms of PPP, each is considered separately below.

## Partial privatisation

Many governments, especially in western Europe, have used partial privatisation – where the government remains either a majority or minority owner of the enterprise – as a means of selling down their interests in commercial businesses. Partial privatisation has often involved a public listing of the shares in the business. It has been used most commonly for very large privatisations. Examples include the sale by the Italian government of 32 percent of the shares in the huge electricity and utilities conglomerate Enel and the phased sell-down by the Japanese government of its shares in Nippon Telegraph and Telephone (NTT): the 1987 and 1988 government sell-downs of NTT are the world’s largest ever public share offerings.

As noted in section 6, partial privatisation can have some advantages over full state ownership. Many countries have used partial privatisation as a way of introducing at least limited private sector disciplines into state-owned enterprises, and of addressing political opposition to outright privatisation. Further, the public listing of a partially government-owned enterprise can increase the information that is available to the public and permit better monitoring of the performance of the enterprise.

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[83] OECD (2002) p 43.

However, partial privatisation has significant disadvantages compared with full privatisation. Ownership of partially privatised companies is often widely held (outside the government's stake) and control is not readily contestable; private investors have limited incentive to monitor the company, relying instead on the 'deep pockets' of the government to bail out the company if it gets into difficulty; and the company remains open to political interference. Further, governments, as owners, may be unable to agree for long as to why they own the company, thus making it difficult for the company to develop and implement a strategic direction.

The empirical evidence supports the view that partial privatisation is not a desirable long-run state. Most studies indicate that there is no lasting difference between the performance of fully state-owned and partially state-owned enterprises: that is, that full private control is necessary to achieve sustained performance gains.[84] But as a stepping stone towards full privatisation, partial privatisation has merits.

## Contracting out

Contracting out has long been used in the private sector as a way for companies to reduce costs by focusing on their core activities while outsourcing the rest. In the public sector, contracting out is becoming more prevalent, as governments recognise they can achieve their objectives by purchasing an activity without needing to incur all the risks and complications of ownership.

Examples of contracting out can be found across the public service. Governments in the United Kingdom have led the way, with the Blair Labour government now redefining the traditional boundary between the public and private services in such areas as defence, justice and transport.[85] In many countries, contracting out has become increasingly common in the social services. In the United Kingdom, for example, the Blair government has made gradual but definite moves to involve the private sector in the delivery of health care and educational services. In the United States, a survey of state departments indicates more than 85 percent of social service agencies reported increasing their use of contracting out with childcare contracted out most often, and such services as food stamp issuance, provision of domestic violence programmes, emergency shelter and refugee services also common.[86]

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84 See, for example, Boardman and Vining (1989) and Ehrlich *et al* (1994).

85 For example, in defence, such sensitive areas as Britain's nuclear arsenal and its premier national scientific research laboratories are now operated by private businesses; in justice, all new prisons are to be designed, built, financed and operated by private firms (with no in-house bid by the Prison Service allowed), support services in a number of policing agencies (such as pathology services, secure evidence storage and security at crime scenes) have been contracted out and civilianisation of some frontline policing functions is occurring; and in transport, the next generation of intelligent traffic management will largely be implemented through PPPs and England's first toll road is now being built. Refer Sturgess (2002).

86 'States Expand Privatisation of Social Services' by Robin A Johnson, March/April 2001, http://www.heartland.org.ia/marapr01.

Contracting out can bring significant advantages. In New Zealand, some central and local government agencies have vigorously pursued contracting out, with cost savings of up to 30 percent or more achieved. But there are also risks with contracting out. If the contract is not well specified or monitored, there is a risk that the private sector enjoys the profits while the public sector ends up bearing the risks.

As with all the activities covered by this report, the key is to take a case by case approach, comparing the costs of contracting out – including the costs of writing, monitoring and enforcing the contract – with the costs of in-house provision. The critical issue is whether the provider's performance can be defined and measured. The UK National Audit Office, a public sector watchdog, found that, despite teething problems, even the early PPP deals have resulted in better value for money. However, the initial results in education in particular have been mixed.[87]

## Private funding of public services

Private funding of public services is another area that may or may not be beneficial, depending on the circumstances of the specific case. Critically, if the private sector finances and shares in the rewards of an activity, it must also bear its portion of the risks.

Private financing can bring benefits to both the private and public sectors if it leads to better asset management and to the risks of a project being borne by those best able manage them. However, if risk is supposedly being transferred to the private sector, the government must be prepared to let the private company that is supplying the public good or service fail. If not, then the purpose of the private funding will be largely, if not wholly, undermined. Further, the government's financial accounts will mislead if the funding is 'off the government's balance sheet' and the implicit government guarantee is not recognised.[88]

In Australia, the states of Victoria and New South Wales have, for many years, used the private sector to help finance roads and tunnels. Now, the Labor governments in these states are looking to "channel private money into public schools and hospitals, courts, community water treatment plants and public housing, aiming to push some of the risk of building and maintaining public facilities onto business".[89]

In the United Kingdom under the Blair government, similar 'Private Financing Initiatives' (as they are known there) accounted for 9 percent of total public investment between 1997 and 2000.[90]

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87 Sturgess, *op cit*.

88 'Enron on Thames', *The Economist*, 28 March 2002.

89 'Going private: a $20b shake-up', *Australian Financial Review*, 11 February 2002.

90 'Partnerships share the load', *Australian Financial Review*, 18 February 2002.

Overall, whether a PPP is likely to be beneficial or not depends on the details of the particular case. If the private sector is purely a source of finance and is bearing little or no risk, then the PPP is likely to be of no or even negative value. If, on the other hand, the private sector bears real risk and/or is able to bring expertise in running the business, there are likely to be benefits to both the public and private sectors.

# 9

# CONCLUSIONS

Achieving the right balance between the roles of the public and private sectors is a challenge that governments are constantly addressing. It is not a question of intervention versus laissez-faire – a popular dichotomy, but a false one. Competitive markets are the best way yet found for efficiently producing and distributing goods and services. But markets cannot operate in a vacuum – they require a legal and regulatory framework that only governments can provide.

Further, in many tasks, markets prove inadequate and governments must intervene. Where intervention is cost effective, the government has many choices on which policy instrument is likely to work best.

One form of government intervention that much has been learnt about through decades of experience is government ownership of commercial enterprises. There was strong debate on whether government ownership of businesses mattered in the 1970s and 1980s. This is now a much more settled issue.

The balance of evidence indicates clearly that government ownership of commercial enterprises is unlikely to be an efficient durable intervention. The raft of studies done over the last 20 years shows overwhelmingly that, on average and over time, the performance of privately owned businesses is superior to state-owned ones.

Further, government ownership of commercial businesses is a costly and non-transparent way for the government to achieve its social goals. A privileged few may benefit from state ownership. But the great majority of those on lower incomes are likely to be penalised, indirectly through the negative impact of state ownership on the economy and directly through the poorer, more expensive services that state enterprises often provide. There are almost certainly better, more efficient, ways for governments to achieve their economic and social objectives than owning commercial enterprises.

Megginson and Netter conclude on the basis of their extensive review of the empirical literature: "we (now) know that privatisation 'works' in the sense that divested firms almost always become more efficient, more profitable, and financially healthier, and increase their capital investment spending".[91] We also know that the gains are likely to be large.

That is not to say that private firms always outperform public enterprises. But the evidence shows clearly that they usually do. As the World Bank puts it, "there is a high

[91] Megginson and Netter, *op cit*, p 381.

probability of efficient performance in private enterprise".[92] And, given the major role that government businesses still play in New Zealand, that matters.

Privatisation programmes around the world over the last two decades have significantly reduced the role of state-owned enterprises in most countries. The share of global output of SOEs has halved (from more than 12 percent in 1979 to less than 6 percent) over the 1980–2000 period.[93]

Although it was not an early starter, New Zealand was in the leading group of countries in terms of privatisation in the late 1980s. But that has long since changed with the stop-start record of privatisation in New Zealand over the last decade and the continued implementation of privatisation in many other countries. New Zealand is now lagging international best practice in several important areas, including the privatisation of accident insurance, broadcasting, electricity, housing, postal services, roading and water. Further, in many parts of the world, including Australia, the United Kingdom and the United States, governments are now increasing the role of the private sector through 'public–private partnerships' in providing social services such as health and education.

New Zealand could benefit substantially from reinstating a programme whereby the government withdraws progressively from owning commercial enterprises. The evidence indicates that the businesses would become more efficient and entrepreneurial and consumers would benefit from lower prices and better services. Overall, New Zealand's economic growth rate would be likely to rise as a result. In addition, the government would be better able to focus on those essential activities – such as defence, external relations, law and the provision of safety net assistance – where it has a comparative advantage. The current halt to privatisation in New Zealand means New Zealand is slipping behind the great majority of other countries where governments are progressively pulling out of owning commercial businesses.

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92 World Bank (1992) p iii.

93 Megginson and Netter, *op cit*, p 328.

# ANNEX I
# POSSIBLE PRIVATISATIONS: 2002/03
# (EXCEEDING €500M)

| *Company* | *Country* | *Sector* |
|---|---|---|
| Agricultural Bank | Greece | Finance |
| Air India | India | Transport |
| Belgacom | Belgium | Telecoms |
| Bharat Petroleum | India | Oil and Gas |
| Biochim Bank | Bulgaria | Finance |
| Brussels National Airport | Belgium | Transport |
| Capitaland | Singapore | Property |
| Cesky Telecom | Czech Republic | Telecoms |
| China Air | Taiwan | Transport |
| China National Offshore Oil | China | Oil and Gas |
| Chunghwa Telecom | China | Telecoms |
| DBS Group Holdings | Singapore | Finance |
| Eircom[1] | Ireland | Telecoms |
| ENEL II[1] | Italy | Utilities |
| Fortum Oyj | Finland | Energy |
| Hellenic Petroleum | Greece | Oil and Gas |
| Indian Airlines | India | Transport |
| Korea Telecom[1] | Korea | Telecoms |
| Kepco | Korea | Electricity |
| Hindustan Petroleum | India | Oil and Gas |
| MOL IV[1] | Hungary | Oil and Gas |
| Maruti Udyog | India | Automobile |
| Nalco | India | Manufacturing |
| Oil and Gas assets | Romania | Oil and Gas |
| PKN | Poland | Oil and Gas |
| POAS II[1] | Turkey | Oil and Gas |
| Postal Savings Bank | Greece | Finance |
| PSA Corp | Singapore | Transport |
| Schiphol[1] | Netherlands | Transport |
| Seoul Bank | Korea | Finance |
| South African Telecom | South Africa | Telecoms |
| Statoil | Norway | Oil and Gas |
| Sydney Airport | Australia | Transport |
| Telekom Austria | Austria | Telecoms |
| Telenor | Norway | Telecoms |
| T-Mobile | Germany | Telecoms |
| TPSA II[1] | Poland | Telecoms |
| Turk Telecom | Turkey | Telecoms |
| VSNL | India | Telecoms |

[1] Follow-on sale.
*Source*: OECD and public sources.

# ANNEX 2

## SYNOPSIS OF RECENT STUDIES ON THE EFFECTS OF OWNERSHIP ON PERFORMANCE

### A. FULLY OR LARGELY COMPETITIVE INDUSTRIES

| *Author/year* | *Industry* | *Country/ period* | *Explanatory variable* | *Performance variable* | *Effects found* | *Method* |
|---|---|---|---|---|---|---|
| Eckel, Eckel and Singhal, 1997 | Air (British Airways) | UK 1987 | Privatisation | Stock Value | Positive | Descriptive |
| Gonenc and Nicoletti, 2000 | Air | 27 OECD countries 1996 | Private vs Public | Efficiency | Positive | Econometric |
| Dewenter and Malatesta, 1998 | High information | 63 firms 1981–93 cross-country pre/post-privatisation | Privatisation | Profitability<br>Efficiency | Positive<br>Positive | Descriptive |
| Boardman and Vining, 1989 | Miscellaneous | 500 largest non-US firms 1983 cross-country | Private vs Public<br>Corporatisation | Profitability<br>Efficiency | Positive<br>Positive | Econometric |
| Boubakri and Cosset, 1998 | Miscellaneous (utilities included) | 79 firms 1980–92 developing countries pre/post-privatisation | Privatisation | Profitability<br>Efficiency | Positive (higher in non-competitive industry) | Descriptive |
| Button and Weyman-Jones, 1992 | Miscellaneous | Survey of 9 DEA studies, US and European firms | Private vs Public | Efficiency | Positive | Descriptive |
| Claessens *et al*, 1997 | Miscellaneous | 706 firms Czech 1992–95 | Privatisation | Tobin's Q | Positive (but especially if large investors) | Econometric |
| D'Souza and Megginson, 1999 | Miscellaneous (utilities included) | 85 firms 1990–96 OECD and developing countries pre/post-privatisation | Privatisation | Profitability<br>Efficiency | Positive (higher in non-competitive industry) | Descriptive |
| Frydman *et al* 1998 | Miscellaneous | 128 firms East Europe 1990–93 matched sample with privatised and public firms | Privatisation | Profitability<br>Efficiency | Positive (but only if outside investors) | Econometric |

*continued*

| *Author/year* | *Industry* | *Country/ period* | *Explanatory variable* | *Performance variable* | *Effects found* | *Method* |
|---|---|---|---|---|---|---|
| Galal *et al*, 1992 | Miscellaneous (utilities included) | 12 firms cross-country | Privatisation | Welfare | Positive | Counter-factual |
| La Porta, Lopez de Silanes, 1999 | Miscellaneous (utilities included) | 218 firms Mexico 1992 pre/post-privatisation matched sample with privatised and public firms | Privatisation | Profitability<br>Efficiency | Positive | Econometric |
| Martin and Parker, 1995 | Miscellaneous | 11 UK firms 1981–88 pre/post-privatisation | Privatisation | Profitability<br>Efficiency | Mixed | Econometric |
| Megginson *et al*, 1994 | Miscellaneous (utilities included) | 61 firms 1961–89 | Privatisation | Efficiency | Positive | Descriptive |
| Pohl *et al*, 1997 | Miscellaneous | 6,300 firms East Europe 1992–95 cross-country matched sample with privatised and public firms | Privatisation | Efficiency | Positive | Econometric |
| Vining and Boardman, 1992 | Miscellaneous | 500 largest firms Canada 1987 | Private vs Public<br>Corporatisation | Profitability<br>Efficiency | Positive<br>Unclear | Econometric |
| Barberis *et al*, 1996 | Retail | 452 firms Russia 1990 | Privatisation | Restructuring effort | Positive (but only if outside investors) | Descriptive |

*continued*

## B. INDUSTRIES WITH NON-COMPETITIVE SECTORS

| *Author/year* | *Industry* | *Country/ period* | *Explanatory variable* | *Performance variable* | *Effects found* | *Method* |
|---|---|---|---|---|---|---|
| Burns and Weyman-Jones, 1994 | Electricity | UK 1981–93 | Privatisation | Efficiency | Positive | Data Envelope Analysis |
| Duncan and Bollard, 1992 | Electricity | New Zealand 1987–92 | Corporatisation | Efficiency | Positive | Econometric |
| Hawdon, 1996 | Electricity | Developing countries 1988 | Privatisation | Efficiency | Positive | Data Envelope Analysis |
| Kwoka, 1996 | Electricity | US | Private vs Public<br>Corporatisation | Prices | Negative<br>Positive | Econometric |
| Newbery and Pollitt, 1997 | Electricity (CEGB) | UK 1990 | Privatisation | Efficiency<br>Environment<br>Welfare | Positive<br>Positive<br>Negative | Counter-factual |
| Pollitt, 1995 | Electricity | 95 firms, 9 countries | Private vs Public | Efficiency | Positive | Econometric |
| Steiner, 2000 | Electricity | 19 OECD countries, 1986–96 | Privatisation | Efficiency<br>Prices | Positive<br>Positive | Econometric |
| Yarrow, 1992 | Electricity | UK 1990–91 | Privatisation | Prices | Negative | Counter-factual |
| Ramamurti, 1997 | Rail (Ferrocarilla Argentinos) | Argentina | Privatisation | Efficiency | Positive | Descriptive |
| Boylaud and Nicoletti, 2000 | Telecommunications | 23 OECD countries, 1991–97 | Privatisation | Efficiency<br>Prices | Unclear | Econometric |
| Staranczack *et al*, 1994 | Telecommunications | 10 OECD countries 1984–97 | Private vs Public | Efficiency | Positive | Econometric |
| D'Souza, 1998 | Telecommunications | 17 firms 1981–94 cross-country | Privatisation | Profitability<br>Efficiency | Positive | Descriptive |

*Source*: Gonenc *et al*, *op cit*.

# ANNEX 3

## EMPIRICAL ESTIMATES OF THE PERFORMANCE OF NEWLY PRIVATISED FIRMS

This annex presents the results of three studies that compare the three-year average operating and financial performance of a combined sample of 211 privatised firms with the average performance of those firms during their last three years as SOEs. The studies employ the Wilcoxon rank sum test to test for the change in median value, and use multiple proxies for most economic variables being measured. A z-statistic with an absolute value greater than two implies the result is statistically significant at the five percent level.

| *Variables and studies cited* | *Number of observations* | *Mean value before privatisation* | *Mean value after privatisation* | *Mean change due to privatisation* | *Z-statistic for difference in performance* | *Percent of firms with improved performance* | *Z-statistic for significance of percentage change* |
|---|---|---|---|---|---|---|---|
| **Profitability (net income/sales) (%)** | | | | | | | |
| Megginson, Nash and van Randenborgh, 1994 | 55 | 0.0552 (0.0442) | 0.0799 (0.0611) | 0.0247 (0.0140) | 3.15*** | 69.1 | 3.06*** |
| Boubakri and Cosset, 1998 | 78 | 0.0493 (0.0460) | 0.1098 (0.0799) | 0.0605 (0.0181) | 3.16*** | 62.8 | 2.29** |
| D'Souza and Megginson, 1999 | 78 | 0.14 (0.05) | 0.17 (0.08) | 0.03 (0.03) | 3.92*** | 71 | 4.17*** |
| *Weighted Average* | 218[a] | 0.0862 | 0.1257 | 0.0396 | | 67.6 | |
| **Efficiency (real sales per employee)** | | | | | | | |
| Megginson, Nash and van Randenborgh, 1994 | 51 | 0.956 (0.942) | 1.062 (1.055) | 0.1064 (0.1157) | 3.66*** | 85.7 | 6.03*** |
| Boubakri and Cosset, 1998 | 56 | 0.9224 (0.9056) | 1.1703 (1.1265) | 0.2479 (0.2414) | 4.79*** | 80.4 | 4.60*** |
| D'Souza and Megginson, 1999 | 63 | 1.02 (0.87) | 1.23 (1.16) | 0.21 (0.29) | 4.87*** | 79 | 5.76*** |
| *Weighted Average* | 170 | 0.9733 | 1.1599 | 0.1914 | | 81.5 | |

*continued*

| *Variables and studies cited* | *Number of observations* | *Mean value before privatisation* | *Mean value after privatisation* | *Mean change due to privatisation* | *Z-statistic for difference in performance* | *Percent of firms with improved performance* | *Z-statistic for significance of percentage change* |
|---|---|---|---|---|---|---|---|
| **Investment (%) CAPEX/sales** | | | | | | | |
| Megginson, Nash and van | 43 | 0.1169 | 0.1689 | 0.0521 | 2.35** | 67.4 | 2.44** |
| Randenborgh, 1994 | | (0.0668) | (0.1221) | (0.0159) | | | |
| Boubakri and Cosset, 1998 | 48 | 0.1052 | 0.2375 | 0.1322 | 2.28** | 62.5 | 1.74* |
| | | (0.0649) | (0.1043) | (0.0137) | | | |
| D'Souza and Megginson, 1999 | 66 | 0.18 | 0.17 | –0.01 | 0.80 | 55 | 0.81 |
| | | (0.11) | (0.10) | (–0.01) | | | |
| *Weighted Average* | 154 | 0.1405 | 0.1900 | 0.0493 | | 60.6 | |
| **Output (real sales, adjusted by Consumers Price Index)** | | | | | | | |
| Megginson, Nash and van | 57 | 0.899 | 1.140 | 0.241 | 4.77*** | 75.4 | 4.46*** |
| Randenborgh, 1994 | | (0.890) | (1.105) | (0.190) | | | |
| Boubakri and Cosset, 1998 | 78 | 0.9691 | 1.220 | 0.2530 | 5.19*** | 75.6 | 4.58*** |
| | | (0.9165) | (1.123) | (0.1892) | | | |
| D'Souza and Megginson, 1999 | 85 | 0.93 | 2.70 | 1.76 | 7.30*** | 88 | 10.94*** |
| | | (0.76) | (1.86) | (1.11) | | | |
| *Weighted Average* | 209[a] | 0.9358 | 1.7211 | 0.8321 | | 80.3 | |
| **Employment (total employees)** | | | | | | | |
| Megginson, Nash and van | 39 | 40,850 | 43,200 | 2,346 | 0.96 | 64.1 | 1.84* |
| Randenborgh, 1994 | | (19,360) | (23,720) | (276) | | | |
| Boubakri and Cosset, 1998 | 57 | 10,672 | 10,811 | 139 | 1.48 | 57.9 | 1.19 |
| | | (3,388) | (3,745) | (104) | | | |
| D'Souza and Megginson, 1999 | 66 | 22,941 | 22,136 | –805 | –1.62 | 36 | –2.14** |
| | | (9,876) | (9,106) | (–770) | | | |
| *Weighted Average* | 162 | 22,936 | 23,222 | 286 | | 49.5 | |

*Notes:*
[a] Number exceeds 211 because of overlapping firms in different samples.
*** Indicates significance at the 1 percent level.
** Indicates significance at the 5 percent level.
* Indicates significance at the 10 percent level.
*Source*: Megginson and Netter *op cit*.

# ANNEX 4
# NEW ZEALAND PRIVATISATIONS: A CHRONOLOGY

The following table lists the major privatisations undertaken in New Zealand since 1987.

| *Year*[1] | *Business* | *Sale price $m* | *Buyer(s)* | *Principal domicile of buyer(s)*[2] |
|---|---|---|---|---|
| 1988 | NZ Steel | 327 | Equiticorp | M |
| | Petrocorp | 801 | Rossport Inv Ltd | M |
| | DFC | 111 | NPF (80%) | D |
| 1989 | Postbank | 678 | ANZ | M |
| | Shipping Corp | 31 | ACT(NZ) Ltd | F |
| | Air NZ | 660 | BIL, Qantas, JAL, AAL | M |
| | Landcorp mortgages | 49 | Mortgagors | M |
| | Rural Bank | 687 | Magneton Holdings Ltd | M |
| 1990 | Govt Print | 38 | Rank Group | D |
| | State Insurance | 735 | Norwich Union | F |
| | Tourist Hotel Corp | 72 | Southern Pacific | F |
| | Synfuels | –90 | Fletcher Challenge | M |
| | Telecom | 4,250 | Bell South, Ameritech | F |
| | Forestry cutting rights | 1,025 | Various | M |
| 1992 | Timberlands | 366 | ITT Rayonier | F |
| | Export Guarantee Ltd | 20 | State Insurance | F |
| | Housing Corp Mortgages | 2,404 | Various banks | M |
| | Petroleum Mining Licences | 120 | Petrocorp/Sthn Petroleum | M |
| | Bank of NZ | 850 | NAB | F |
| 1993 | NZ Rail | 328 | Wisconsin, Berkshire, Fay Richwhite | M |
| | Fletcher Challenge Shares | 418 | Financial Institutions | M |
| 1994 | Govt Computer Services | 47 | EDS Holdings | F |
| 1996 | Maori Development Corp | 21 | Maori Dev Corp | D |
| | Forestry Corporation | 1,600 | FCL, Citifor, BIL | M |
| | Works Development Services | 108 | Downer, Kinta Kellas | M |
| 1998 | Auckland Airport Ltd | 460 | Public Share Float | M |
| | Wellington Airport Ltd | 96 | Infratil NZ-led consortium | M |
| | Capital Property Services | 119 | Public Share Float | M |
| 1999 | Contact Energy Ltd | 2,331 | Edison and Public Float | M |
| | Vehicle Testing NZ | 19 | Motor Trade Inv | D |

*Notes*:
[1] Date of first settlement.
[2] D = 75 percent or more domestic-owned.
F = 75 percent or more foreign-owned.
M = mixed: that is, more than 25 percent domestic and more than 25 percent foreign-owned.
*Source*: http://www.treasury.govt.nz/assetsales/default.asp. Indications of domicile are the author's estimates. Other minor assets that have also been sold are not included in the table above.

# ANNEX 5
## NEW ZEALAND STATE-OWNED ENTERPRISES AND CROWN-OWNED ENTITIES

| *Business* | *Principal activity* | *Assets $m* | *Equity $m* |
|---|---|---|---|
| **State-owned enterprises** | | | |
| Agriquality NZ Ltd | Agricultural services | 25 | 15 |
| Airways Corporation of NZ Ltd | Air traffic control services | 104 | 43 |
| Asure NZ Ltd | Meat inspection services | 12 | 5 |
| At Work Insurance Ltd[1] | Residual accident insurance | 5 | 5 |
| Electricity Corporation of NZ Ltd | Residual electricity | 867 | 22 |
| Genesis Power Ltd | Electricity generation and retailing | 1,105 | 848 |
| Landcorp Farming Ltd | Farming | 561 | 491 |
| Meridian Energy Ltd | Electricity generation and retailing | 2,669 | 1,780 |
| Meteorological Service of NZ Ltd | Meteorological services | 13 | 8 |
| Mighty River Power Ltd | Electricity generation and retailing | 1,614 | 713 |
| New Zealand Post Ltd | Postal services | 630 | 209 |
| New Zealand Railways Corp | Rail corridor | 9 | 7 |
| Solid Energy NZ Ltd | Coal mining and marketing | 131 | 43 |
| Television NZ Ltd[2] | Broadcasting | 520 | 343 |
| Timberlands West Coast Ltd | Forestry | 79 | 72 |
| Transpower NZ Ltd | Electricity transmission | 2,280 | 950 |
| Total SOEs | | 10,624 | 5,554 |
| **Crown-owned entities** | | | |
| Accident Compensation Corporation[3] | Accident insurance | 3,781 | –3,879 |
| Crown Research Institutes | Research | 435 | 319 |
| District Health Boards | Healthcare providers | 2,632 | 935 |
| Earthquake Commission | Earthquake insurance | 3,897 | 3,841 |
| Housing Corporation of NZ[4] | Housing loans and administration | 297 | 45 |
| Housing NZ Ltd[4] | Residential landlord | 4,185 | 2,850 |
| Museum of NZ Te Papa Tongarewa | Museum | 847 | 841 |
| NZ Fire Service | Fire services | 283 | 185 |
| School Boards of Trustees | Schools | 1,383 | 826 |
| Tertiary Education Institutes | Universities | 2,725 | 2,178 |
| Other | Other | 945 | 382 |
| Total COEs | | 21,410 | 8,523 |
| **Total SOEs and COEs** | | **32,034** | **14,077** |

*Notes*:
[1] At Work Insurance no longer exists.
[2] Television New Zealand (TVNZ) will be removed from the list of SOEs with passage of the TVNZ Bill 2002, which will make TVNZ a COE with a mix of commercial and non-commercial objectives.
[3] The negative equity in ACC reflects the Corporation's outstanding claims liabilities.
[4] The Housing New Zealand Corporation replaces both the old Housing Corporation of New Zealand and Housing New Zealand.
[5] We understand that Air New Zealand will be defined as an SOE for reporting purposes, although because it is 82 percent, not 100 percent, state owned it is not an SOE as defined in the State-Owned Enterprises Act 1986.
*Source*: Financial Statements of the Government of New Zealand, 30 June 2001.

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