



# Privatisation: an agenda for the South Pacific

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There are many gains in economic efficiency to be made by the implementation of programs of privatisation—in all its forms—in the island states of the South Pacific. But programs should be implemented only after rigorous analysis of possible adverse consequences. Privatisation is but one facet of an overall program of economic and public administration reform. Here a privatisation model includes policy improvements avoiding crowding out, contracting out, commercialisation, corporatisation and divestiture.

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Privatisation has been the focus of one of the major debates in public administration over the last decade. It is a phenomenon which has been strongly influenced by ideology, but also by pragmatism. All types of governments have embraced privatisation in its many forms. What this means for public administration in industrialised countries is that governments are retreating from production towards the core roles—policy setting, regulation and delivery of some services. Even regulation and service delivery have seen marked changes. Privatisation, in its various forms, is common throughout the industrialised world and generally speaking, the results of its implementation appear to be positive. Given this success, it would appear logical that the same advantages could also be gained by developing economies, including those in the South Pacific.

## Why privatise?

Privatisation is concerned with obtaining greater efficiency in the production of public sector goods and services through an expansion, or potential expansion, of the role of the private sector. Privatisation can include the operation of government units in accordance with full commercial principles, with a corporate structure but retaining public ownership (generally termed corporatisation), the operation of government units in accordance with commercial principles but with a public service structure (commercialisation), the contracting-out of government services to the private sector and finally, what is erroneously considered by some to be the only meaning, the change of ownership of an organisation from the public to the private sector (divestiture). All of these terms are used here.

There are three principal reasons to institute a privatisation regime.

- Under private ownership, managers have more incentive to maximise benefits to the owners. Improved performance raises the value of stock which, in turn, raises further capital, decreases the prospects of bankruptcy as well as the likelihood of replacement by new management (Vining and Poulin 1989:19).
- A privatised government body will lead to improved economic and technical outcomes because the private sector can achieve a higher level of both allocative and productive efficiency than the public sector (Chin and Webb 1987:28).
- Without the threat of bankruptcy, there is little or no incentive to contain costs or improve efficiency (Chin and Webb 1987:30–1).
- For a privatised government body, there is less likelihood of political interference than with a government body (Vining and Poulin 1989:19).

### **Do developing economies have reasons not to privatise?**

How appropriate is privatisation to developing economies? Are developing economy conditions just as relevant to arguments for privatisation as they are in industrialised economies? There are particular circumstances in developing economies which need to be considered. Public enterprises serve valuable development functions, particularly in education and employment, as well as encouraging private enterprise through multipliers and other flow-ons. In some developing regions public enterprises are the only possible employers and, without income maintenance systems, large-scale employment losses can cause considerable personal hardship.

Developing economy governments usually lack the full range of policy

instruments open to industrial economies, particularly in respect of tax regimes and effective instruments of regulation. Privatised enterprises, therefore, may not produce as effectively as public enterprises (Heald 1990:13). Also, there is usually only a small domestic capital base and, therefore, little capacity to buy out public enterprises. If there is no viable domestic buyer for a public enterprise, it may be considered undesirable for political and strategic reasons to attract foreign investment to provide the service.

The lack of competition to public enterprises (often the case in developing economies) may be a sound reason not to privatise—there would simply be a substitution of a private monopoly for a public monopoly with no economic gain.

### **Privatisation as part of policy reform**

Privatisation is but one tool in an overall regime of economic and public administration reform. A policy environment conducive to economic growth is essential for economic well-being. If a public enterprise is to be viable, it should not rely on the government budget for capital injection. It should access the general banking and private capital market systems. Inefficient public enterprises often operate in a context of high protection. Privatisation without tariff reform is useless from the point of view of increasing economic efficiency. An inefficient private enterprise is just as bad as an inefficient public enterprise. The mistake should not be made, as some privatisation enthusiasts would want, to limit exposure to newly privatised industries to market forces either internationally, or domestically.

Reforms such as encouraging private investment (through tax, land, public utilities and other incentives), more

efficient taxation regimes, better private sector training opportunities, encouraging domestic savings, avoiding crowding out the private sector by inappropriate public enterprise activities, contracting out government services to private enterprise (often on a very small scale) are all essential elements of policy reform. Corporatisation of public enterprise (that is, the operation of public enterprises along commercial lines and without political interference or calls on the budget) might also be an appropriate policy reform as it clarifies the objectives of public sector organisations, makes any operating subsidies more apparent and leads to better informed decisions on the desirability or otherwise of the retention of their ownership by government. After all these processes have been considered, selective privatisation of inefficient and loss-making public enterprises might be appropriate.

Heald (1990:10) urges reform of the institutional framework for the private sector as a prerequisite for a successful privatisation program. In addition, he includes in his suggestions for policy reform the adoption of a competition policy, corporate disclosure and corporate ownership patterns. Policy reform of public enterprises is very much overdue in many developing economies. The key concept for reform measures is competition: economic efficiency will be encouraged with the resultant better use of scarce resources (including government and aid donor funds). Consumers will benefit from lower costs.

### **An appropriate privatisation policy**

Ideally, privatisation works if a large number of small, inefficient public enterprises overload the monitoring capacity of government. Advantages would be the freeing up of government capacity to concentrate on more appropriate areas of activity and the

benefits to the economy and to consumers of more efficient enterprises. Another, most important, benefit relates to the capacity of the domestic capital market to purchase privatised enterprises. Small-scale public enterprises are more likely to be within the capacity of domestic capital to acquire than large enterprises. In turn, more domestic capital would be produced by the operation of efficient privatised enterprises. There has been some, but insufficient, consideration given by donors to providing financial assistance as equity directly to the private sector in developing economies.

### **The role of government in South Pacific development**

The rapid growth and the pervasive influence of government in the South Pacific has resulted in the private sector playing a relatively minor role in the development process.

Government rather than private enterprise is involved in addressing low levels of education, employment, health standards and general economic and social development. Together with the relatively low level of an indigenous private enterprise ethic, this has resulted in an unbalanced growth of the public as opposed to the private sector.

Inappropriate government policies have resulted in the over-regulation of the business environment, excessive government intervention in the economy, unsustainable policy approaches in relation to fiscal, monetary, exchange rate and wage policies (Fairbairn 1992:3).

The need to provide for public infrastructure for development purposes (especially roads, port and airport facilities, public utilities and telecommunications) has meant that public works and similar departments have not only provided this infrastructure themselves but have dominated the overall construction and maintenance industries. In agriculture,

government productive activity was initially the only way to produce case crops as opposed to traditional subsistence cropping. Government has consumed the major slice of training places in overseas education institutions. Such interventions can only be justified for a finite period. Unfortunately, worldwide experience has shown that governments are not good judges of knowing when to withdraw from an industry.

### **The role of the private sector in South Pacific development**

The countries of the South Pacific are giving increased attention, at least in the rhetoric of their development plans, to achieving economic growth through their private sectors. This reflects their conviction that the fundamental role of the private sector in promoting more efficient allocation of scarce resources, economic growth and employment expansion (Fairbairn 1992:1). In many South Pacific countries, the role of the private sector has taken on added importance. Economic growth has been disappointing throughout the 1980s despite large inputs of aid (World Bank 1991). The heavy dependence on big government has, in practice, led to significant misallocation of resources and, from the viewpoint of economic growth, has largely been counter-productive (Fairbairn 1992:2). The encouragement of policies to promote the private sector is seen as one way of turning economic development around so that genuine growth can take place.

### **A privatisation model for the South Pacific**

Appropriate privatisation policies for the South Pacific in the context of overall economic policy (especially public enterprise) reform can assist economic growth. A privatisation model for the

South Pacific along the following lines would incorporate broad applications of the term including improving the policy environment, avoiding crowding out, contracting-out, commercialisation, corporatisation and divestiture.

#### **Improving the policy environment**

Paradoxically, governments of South Pacific countries must take the responsibility for encouraging appropriate privatisation by doing what governments do best—making policy. Among key areas that warrant attention are fiscal, monetary and exchange rate policies, tax reforms, sectoral priorities, infrastructural development, financial facilities, the provision of incentives for domestic and foreign investment and the legal and regulatory framework (Fairbairn 1992:7).

#### **Avoiding crowding out**

Governments agencies and public enterprises have usually acted as monopolies by dominating certain industries. Private enterprise should be allowed to function competitively and not be crowded-out by the public sector. Government projects should be open to competitive tender by private sector as well as public sector enterprises (New Zealand Ministry of External Relations and Trade 1990:17). This would entail a fundamental re-think of the role of public works departments. Rather than undertake construction and maintenance work themselves, these departments should manage the public infrastructure responsibilities of government and oversee the work of private sector contractors.

#### **Contracting out**

There are many aspects of government activity which could be supported or undertaken on behalf of government by private enterprise. Examples of contracting out include the provision of cleaning services for public service buildings, the

supply of equipment, stores and supplies to government, private sector provision of payroll and recruitment services and the undertaking of public infrastructure work, (for example, road construction and maintenance, public works equipment hire and maintenance).

Competitive tendering among local contractors should be introduced for public works projects. In many cases, the stock of private contractors will come from former public sector employees made redundant by other aspects of the privatisation process. This is already happening in some South Pacific countries, most notably in Niue, despite its size.

In many small countries of the South Pacific, the private sector would not have the capacity to own and operate some equipment such as heavy road construction plant. An appropriate privatisation solution would be for a government to own plant and to hire it out to local construction contractors. Much of the contractors' work, but not all, would be for public works projects. The government should also divest the maintenance of plant but retain a management and quality control function. There is clear potential for this in Solomon Islands, Vanuatu, Western Samoa and Tonga.

### **Commercialisation**

Governments should reform their public services to separate out core functions, such as policy advice and the provision of some services, from commercial activities. Business units which charge customers on a cost recovery basis should be established within departments. Examples would be the provision of some (non-essential) medical and education services, the sale of maps and other publications and the cost recovery of some agricultural equipment and extension services (on a sliding scale to wean farmers off a totally free service as improved cropping techniques begin to pay).

### **Corporatisation**

Efficient and profitable public enterprises should be reformed and reorganised to operate in accordance with fully commercial principles with a corporate structure and a commercial board, but retaining public ownership. Should it be deemed necessary for these corporations to provide a community service at less than full cost, the government should provide a transparent subsidy as a community service obligation which would be declared in the annual government budgetary process.

### **Divestiture**

Small, inefficient and loss-making public enterprises which overload the monitoring capacity of government should be sold to the private sector. It is a matter for consideration by government whether such a sale should be made to foreign or domestic private interests or a combination of the two.

Through the Australian Joint Equity Financing Scheme and the New Zealand Pacific Islands Industrial Development Scheme there is no provision for Australian and New Zealand aid funds to provide equity funding for indigenous private sector interests to enter into joint ventures with Australian and New Zealand partners. These schemes should be retained, increased in size, be additional to normal bilateral programming budgets and be more widely publicised. Bilateral policy dialogues should encourage their use.

In addition, donor funds should be made available to allow recipient governments to enter into joint venture arrangements with overseas private sector partners to facilitate the partial divestiture of public enterprises. An example would be the mechanical workshops of a Public Works Department. Under such a scheme the recipient government would retain ownership of buildings and equipment—its

equity in the venture. The foreign partner would provide management and human resource services for the venture, maintain equipment and provide hire-out services to small private sector contractors. Government involvement in the ownership of plant and equipment would be appropriate as few local private sector enterprises would have the necessary capital.

### **Privatisation not a panacea, but it will help**

There are many gains in economic efficiency to be made by the implementation of privatisation programs—in all their forms—in the developing economies of the South Pacific. Privatisation policies should not be pursued as a panacea for all the economic problems confronting these countries. It is but one of many facets of reform which should be considered to improve economic performance. Such economic reforms must consider the disadvantages in small, remote developing economies and be aware of the development value of government activity, the small size of domestic capital markets and the prospect of continuing monopolies.

This caution should not be taken to mean that the private sector in the South Pacific should not be given more room and opportunity to operate. Improving the policy environment for private sector activity, including the development of domestic capital markets, is of utmost and immediate importance. Governments should also avoid crowding out and encourage contracting out, commercialisation and corporatisation as well as conduct a rigorous examination of candidates for divestiture.

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