CDE debates

Privatisation: are we going fast enough? Who benefits, who loses?

CDE held its sixth debate on 10 March 1997. The speakers were Kennedy Memani, special adviser to the Ministry of Public Enterprises and an independent financial consultant; Neil Morrison, director of investment banking at Deutsche Morgan Grenfell and former head of policy, money and finance for the ANC; and Thami Mazwai, editor-in-chief of Enterprise magazine and chairperson of the SA National Editors' Forum. CDE board member Professor Charles Simkins of the Department of Economics, Wits University, chaired the debate.

Privatisation has long been an issue in the South African economy. It was one of the key issues debated in the 1980s as the worldwide trend towards privatisation took root. After 1990, at the time of the unbanning of the extra-parliamentary parties, the debate was reopened. Now, in the late 1990s, with the new democratic government in place, the topic is being debated within the government and between government and the private sector. It is a continuing theme and the indications are that South Africa will be concerned with the issue of privatisation for many years to come.

WHAT ARE THE CDE DEBATES?

During 1996 CDE ran a series of debates on topics important to current national policy issues. These will continue in 1997. The intention is to air issues underlying the topic and to raise the challenges that the players and the policy makers must meet. Following each debate, CDE publishes a pamphlet summarising the event. We widely distribute and publicise these as CDE's contribution to keeping the debate alive.

What the speakers had to say...

Kennedy Memani opened the debate by outlining the key principles guiding the Ministry of Public Enterprises: to grow the economy and to reduce the current unemployment level, to have parastatals operate efficiently within accepted business parameters, to step up quality delivery to all South Africans, and to reduce state debt.

He said there is an urgent need to grow the economy by 5% to 6% by the turn of the century, a need which government is addressing in part by restructuring state assets.

Historically, South Africa's parastatals have in the main been operated by civil servants whose principles have not been business driven. Efficiency was not a primary objective or concern. Some parastatals were relying on government subsidies for their existence which brought into question their sustainability. This situation needed to be turned around.

The government has been accused of embracing privatisation solely to reduce state debt. This is an objective, but not the only one. Other countries' experience has shown that privatisation alone does not lead to a reduction of state debt. Rather it is economic growth that will address this problem.

Mr Memani gave an update on the companies that will be restructured during the process:

- **Telkom:** Telekom Malaysia and SBC Communications of the US have earned the contract to become Telkom's strategic equity partners (SEPs). Government is finalising details of this contract as well as plans to offer a further 10% of Telkom to disadvantaged communities.
- **Sun Air:** The privatisation of Sun Air should be completed by the second half of 1997.
- **Aventura:** Aventura has also been earmarked for 100% privatisation. This is being handled without external advisers, and will be driven by a team made up of management, government and labour which will be assisted by the Development Bank of SA and the IDC. There are two bottlenecks: the Dolphin deal in Mpumalanga and various land claims on some of the resorts.
- **Airports Company:** The Airports Company will also be privatised, hopefully by the year end. Again, labour, government and management are handling the restructure. Government tends to think investment by an SEP is the best way to go, but this strategy is being assessed by government advisers and various merchant banks. The win through to the second round of the 2004 Olympic bid has put pressure on this deal for reasons of efficiency and growth.
- **Transnet:** With the restructuring of the various arms of Transnet - SAA and Autonet - the SEP route seems most favourable for SAA. Government still needs to come up with a solution to the Transnet pension fund and medical aid deficit.

Government is spending a great deal of time on restructuring various areas of transport, telecommunications and energy, all key areas of delivery.

On the question of labour, government believes the time hitherto spent on building consensus with the unions was well spent.

Are we moving fast enough with privatisation? The views conflict, depending on who asks the question. Government believes it has moved faster than expected. Who gains from the process? The answer is all South Africans in the light of government's objectives given earlier. South Africa has an obligation to deliver to those who have for so long been excluded from the mainstream of the country's economy.

Neil Morrison introduced his view of the privatisation debate by offering a 'problem statement' on the issue. The objectives, he said, were growth, investment, employment and redistribution. Problems which had already presented themselves or which were anticipated in restructuring state assets included investment and budget constraints, public enterprises' financial statements and sovereign risk. The solutions, in a nutshell, lay in the changing role of the state, transferring risk to the private sector, ensuring an economy-wide efficiency and creating vehicles for empowerment.

Why has the need to privatise arisen in South Africa? The past few years have seen trade and financial liberalisation, the swift emergence of globally competitive markets, changes to the interest rate policy, shifts in agricultural prices and marketing, restructuring of the constitution, the country's institutions and financial regulations, positive shifts in the treasury, and the need to meet the cry for empowerment.

Mr Morrison listed six major forces driving privatisation in South Africa. They cover areas that both overlap and sometimes conflict:

- fiscal, budgetary (the reduction of central government debt and the resultant saving in interest payments)
- promotion of foreign and domestic investment and the forex attraction
- technology transfer and industry modernisation
- RDP
- fostering competition
- ridding government of the management burden.

The fiscal effects of divestiture were worth considering as a separate entity. Central government's debt in 1990/91 amounted to 37% of the GDP. This had risen to 58% currently. If government could dispose of R50bn of state assets in the current financial year, its debt, as a percentage of GDP, would drop to 49%. Put differently, central government debt in 1996/97 is R330bn. If R50bn were to be divested, this would drop to R280bn, and debt servicing would drop from R36bn to R30bn.

Privatisation to the value of R50bn this year, with a concomitant saving of R6bn in interest payments, would reduce the state's deficit as a percentage of GDP from 5.1% to 4%. This would be hugely significant for South Africa; it would push the country towards fiscal stability and away from the possibility of a debt trap. It would also reduce interest rates throughout the economy, including mortgage rates.

"Privatisation should vigorously promote black economic empowerment"

If government goes ahead this year with the restructuring of Telkom, the Airports Company, Sun Air, Aventura, Alexkor and Safcol as has been reported, this should bring in R7bn to R10bn, mostly in foreign investment; a significant amount.

The welfare gains in privatisation, illustrated in countries such as the UK, Chile, Malaysia and Mexico, show that in 12 companies that were privatised, the workers gained in 10 cases, the consumers in seven, the government and the purchasers in nine, and, in all, competition was a winner. The gains were in productivity, pricing and further investment.

Generally, four methods are employed in large scale privatisation: public offerings through the stock market, trade sales (selling the entire organisation to a similar private company), securing a strategic equity partner by selling some shares, and private placement (where usually institutional investors purchase a share holding). Since the 1994 election, only the SEP route has been used in South Africa.

Thami Mazwai began with a summary judgement on privatisation: he was quite happy with the process, but felt it could have gone faster and in a direction that vigorously promotes black economic empowerment.

It is a process that started as part and parcel of the liberation struggle; it cannot be separated from it. Liberation is not only political, but also economic. Seeing privatisation in this context, one can make a fair judgement of how far South Africa has gone.

The yardstick to use is to look at privatisation five years down the line and see to what extent the economy of this country reflects its demographics. If it does not,

CDE debates

privatisation will have betrayed the revolution.

Privatisation must be part and parcel of black economic empowerment. Government will face limitations in this process of empowerment. It must not, for instance, interfere with the private sector. Government should set targets for black empowerment, but it cannot run private companies. Government is not a good producer or businessman. The only area where government can take a lead is in the public sector which includes the parastatals. These are the vehicles through which government must blaze the trail for black economic empowerment of which privatisation is an aspect.

The problem to date with black economic empowerment is that South Africa has not developed a national vision. We must look at countries like Malaysia where economic empowerment was part of the country's national strategy. It must not be purely an act of social responsibility. South Africa, too, must set specific goals: for example, in 30 years time, 70% of the major players must be black. This national vision must not be government's alone, but that of all players in the economy.

It is in this area that the present privatisation drive misses the point. In few of the present deals has much been said about which stake will go to black business, how the process will be managed and what the criteria will be. This is particularly evident in the Aventura, Sun Air, SAA, Autonet and Transnet restructuring.

Government alone is not to blame. Remember that at the time the restructuring was begun, the government was a government of national unity. Government's partners - the NP and the IFP - resisted black economic empowerment and pushed privatisation only for the financial gains of those who could afford to purchase state assets. This, together with an evident lack of commitment to economic empowerment from business (excluding such deals as JCI and Johnnic), is a dampener on the present restructuring process.

There will not be losers if we follow the black empowerment route. Admittedly, at present the benefits of privatisation are going to only a small number of black people. But let us not make the case of a black millionaire the ultimate crime. Becoming a millionaire is part of being involved in the market economy and being an entrepreneur. Do not forget that on the way to becoming a millionaire one creates many jobs. South Africa needs to develop more black entrepreneurs. In so doing, the country will develop more job creators and more tax payers. Job creation is a function of development.

Still on the question of who benefits: a black businessman wanting to get involved in the restructuring process must be judged on his own merits. It is of no consequence how many other black businessmen, or lobbies, he represents. Also, the enterprise wishing to restructure should not be required to first consult the unions and the civics. We are losing sight of how economies develop.

Points raised during open discussion...

Given that the present government enjoys consultation, cooperation and input on its present economic policy, how did the previous government deal with the particular problem of state debt?

Neil Morrison said it would be incorrect to say that all the debt was incurred on projects that did not generate cash. However, the previous government did incur some debt to pay salaries of civil servants and this was the major issue. It is not a bad thing to run fairly large budget deficits for capital expenditure, assuming there is not a huge stock of debt already. The problem is that there has been extremely little expenditure on capital investment in recent years.

If government intends privatisation to increase foreign investment, this implies an attractive investment climate that may, for the foreign investor, translate into favourable taxation policies and a flexible labour policy. Doesn't this mean lower wages? If government is less interventionist in the economy, how will government ensure job creation? How is government going to ensure that privatisation will benefit all South Africans?

Mr Memani replied that the government cannot make foreign investment an objective of privatisation. It is a bonus. On the question of job creation: once competition is introduced, the economy is broadened and more players become involved. Regarding the proceeds of privatisation: these will be spread between capital expenditure, the reduction of state debt and the provision of basic welfare needs.

> *"There is no conceivable reason for keeping Eskom in the public sector"*

At what stage in the privatisation process are Alexkor and Safcol?

Alexkor is a diamond mining company in Alexander Bay. Management, government and labour are still working on a joint position paper that will address the concerns of the competing stakeholders. Key issues are that Alexkor is a main job creator in Northern Cape Province and that the mine still has a life of some 10 years. There has not yet been much progress on Safcol, the state's timber and forestry concern. A committee has been established to draw up the position paper that will guide its restructuring. This should be done by the year-end or early next year.

Is it not irresponsible of Mr Morrison to suggest that we can raise as much as R50bn and, if we could, that the proceeds be used to reduce state debt? There are many competing areas for these proceeds - infrastructure is one. Probably only the privatisation of Eskom would generate the high revenue government so desperately needs.

Mr Morrison said he was not trying to suggest that the proceeds of privatisation should be used purely for reducing state debt. This would be a mistake. He merely wished to show what could be done with the proceeds and that a rearrangement of investment could shift responsibility from government to the private sector. Is R50bn an overestimation? Yes, if one looks only at the present programme. But if one looks at a rough estimate of state assets, these total R125bn. Does one need all these assets in the public sector? Eskom is indeed something of a holy cow. Because it is run efficiently, the feeling is that it should be kept in the public sector. This is illogical; there is no conceivable reason for keeping Eskom in the public sector in the long term. Government can achieve the same social objectives and more through contracts with private sector electricity suppliers.

- A local government councillor commented that many people still distrust the concept and implementation of privatisation for many reasons: the country does not have a national vision and it is still in the grips of a transition. Understanding the projections for job creation is difficult for many South Africans. All concerned in this initiative need to move forward cautiously.
- Why isn't government introducing the desired efficiency into the existing parastatals rather than privatising? A prerequisite of privatisation is that the staffing has to be lean, operating with high-tech efficiency. This is a recipe for disaster in South Africa because of our high unemployment rate which the introduction of state of the art technology will worsen.
- The assumption by the panel that privatisation will benefit everybody in South Africa rather than it having the side effects experienced by the private sector with downsizing is worrying. Also, most black South Africans today are still confined to 'survivalistic' businesses. How will these small business concerns fit into the privatisation process?

Mr Mazwai said he hoped the last speaker was not implying that, because most black South African businesspeople are involved in running micro businesses, they cannot manage larger companies. Black economic empowerment will transform black South Africans into an economic force that will create jobs. Because the old order did not allow blacks to be centre-stage in the economy, this does not mean that black South Africans cannot be centre stage 15 years down the line. A major process that can facilitate this shift is the privatisation of state assets. Job losses

CDE debates

are a matter for concern. Job losses result where the costs of a company are more than the income. If a company does not make profits - whether owned by the government or not - it will have to shed jobs. The essence of running a company is to make profits. Are we going to allow a parastatal with a bloated labour force to retain those workers via a government subsidy? Should workers employed by a parastatal be kept in employment at the expense of the taxpayer? In that case, why can't workers in the private sector also be given state subsidies? The most important consideration concerning employment is the opportunities privatisation creates for entrepreneurship. The entrepreneur will create jobs for others.

Mr Memani said a national vision on privatisation was indeed embodied in a document drawn up by the Department of Public Enterprises as a guide to the restructuring process. He welcomed additional public input. He noted the concerns raised by the audience and mentioned the National Empowerment Fund that enables black consortiums to bid directly. He pointed out that in most privatisation initiatives government was not going for a full scale sale, but rather for a SEP. He said his ministry and the Department of Trade and Industry were going out of their way to make sure that black business could participate fully in the restructuring process. Government was aware of the superficial 'rent-a-black' tactic and it is government's duty to see that black South Africans are meaningfully involved.

On the issue of labour, he said most of the parastatals had been 'corporatised' and had gone through the process of major job cutting. Regrettably, there would be job losses in the short term, but the long term benefits of this process outweighed the short term implications. The National Framework Agreement which is a bilateral between government and labour, assures both sides that they will work together in situations which could present short-term job losses. Both sides have worked hard to make foreign investors aware of the uniqueness of the South African situation.

Neil Morrison agreed that government should proceed with caution, and it had done so. Downsizing had been disastrous for many private companies; the emphasis has now switched to right sizing, a more delicate and considered process. Privatisation is an important instrument government has at its disposal to achieve directly social objectives such black economic empowerment and wealth distribution. One has to bear in mind that when government opts for policy intervention, someone wins, someone loses. Job losses have occurred in parastatals throughout the world; about one in four jobs has been lost over the last five to seven years in the public business sector. Privatisation is one mechanism of turning around these job losses in the medium term.

Concluding remarks by CDE board member Professor Charles Simkins

From a distributional point of view, privatisation is a complex issue. Many different groups have competing expectations and an actual privatisation deal will have to strike a balance between these.

First, the state wants something. It wants to turn break-even or loss-making companies into enterprises which can yield company tax and VAT.

Secondly, the workers want something. They want, at least, not to be worse off than they are in current state employment, in terms of both wages and security of employment. The second is hard to achieve and, characteristically, employees have to be offered something in exchange, such as shares in the privatised company at zero or below market cost.

Thirdly, consumers want something. They want a better service at a lower price. They do not want to be exploited by a monopoly. If privatisation does not lead to competition, it should at least lead to a regulated monopoly.

Fourthly, the share-owning public wants something. It wants an initial public offering of shares at a price which offers value. Privatisation also offers the opportunity for broadening the base of shareholders.

Fifthly, the private bidders for publicly owned firms want something. They want a price and a business-friendly policy environment which offers opportunities for profit.

There are three other, specifically South African, considerations. The first is that South Africa needs improved technology and can get it through foreign firms buying into the country's publicly owned firms. To achieve this, appropriate incentives have to be offered. The government has chosen a strategic equity partner approach.

The second is that the government wants restructured public companies to achieve RDP objectives, such as the requirements for rural telephones laid down as part of the plan for Telkom.

The third is that black economic empowerment impacts on privatisation by creating a demand for special arrangements to get shares into the hands of black shareholders.

This is a long list of interests. Not all can necessarily be accommodated in every privatisation deal, though all of them will shape the country's eventual privatisation programme. As in other economic decisions, there has to be a trade-off between objectives. There will be gainers and losers. In the end, efficiency improvements are necessary for gains to outweigh losses. Our debate tonight has started to show how complex a policy issue privatisation is.

THE CENTRE FOR DEVELOPMENT AND ENTERPRISE

P O Box 1936, Johannesburg 2000. Pilrig Place, 5 Eton Road, Parktown, Johannesburg 2193, South Africa.
Tel: 27-11-4825140 Fax: 27-11-4825089 e-mail: info@cde.org.za