

# Public Enterprise in an Era of Change


*edited by John R. Allan*

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# Public Enterprise Developments: An International Perspective

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I would like to start by congratulating the provincial government on its decision to stimulate a public debate on the future of public enterprise in Saskatchewan (TASC, 1996; Crown Investments Corporation of Saskatchewan, 1996). From what I have read and heard in the three days I have been in Regina, there are difficult and awkward problems to handle, but I certainly subscribe to the case for transparency and consensus building. As an outsider — and I am very conscious of being an outsider — I am sure that I will get some things wrong about your situation but I hope in this keynote address that I get enough right to engage your interest. What I can contribute is a framework for analysis rather than a set of specific proposals.

It is logical to start with some general comments, before turning to specific circumstances regarding Crown corporations in Saskatchewan. The first thing to mention about the United Kingdom is that almost all commercial public enterprises have been privatized — demonstrating that almost anything *can be sold*, dependent on the terms and conditions. In the present frenzied pre-election atmosphere in the United Kingdom, there was an interesting newspaper leak of confidential letters from the Conservative Central Office to seventy-four privatized companies asking for campaign contributions. This was the first time I had heard this figure of seventy-four, but it is quite a plausible number for those organizations, which Canadians would call Crowns, that have been privatized in the United Kingdom.

There are two key issues which need to be addressed. The first is whether governments actually have any policy choice about what they do in their public enterprise sectors, or in the sphere of economic intervention more generally. A crucial task is to understand very clearly what those policy choices are; which choices are available and which choices are not available.

The second is the relationship between ownership change, competition and regulation. There is a serious danger that public debate focusses exclusively upon ownership change, to the neglect of regulation. One of the most important lessons to be derived from the UK experience is that regulation ought to be at the very heart of privatization discussions, as soon as privatization moves out of clearly competitive sectors. Though this would create no surprise in North America, it certainly did create surprise in the United Kingdom where it was often believed that privatization was going to make everything simpler. Instead, regulation has revealed itself to be an extremely difficult and problematic task (Armstrong et al., 1994; National Audit Office, 1996). If a regulatory system is well designed and implemented, there are substantial benefits to reap. If you design the regulatory

system badly, or compel regulators to work from an unnecessarily difficult starting point, there are very serious difficulties ahead. What surprises most observers of UK utility regulation is how personalized it has become; looking across sectors like gas, telecommunications, electricity and water, one observes developments and decisions which have flowed directly from the views — indeed eccentricities — of the regulators appointed in those areas (Veljanovski, 1993; Heald, 1994b). This highly personalized story about regulation departs not only from British administrative traditions but is also far removed from the due process characteristic of US and Canadian regulation.

## ANALYTICAL ISSUES

One of the most important issues for people in Saskatchewan to address is the difficult problem of separating out *policy objectives* and *policy instruments*. From what I have been told, the pioneers of public enterprise in Saskatchewan viewed the Crowns as an instrument for economic development, doing things which would not otherwise have been done (Pitsula and Rasmussen, 1990). Over time, objectives and instruments become fused — not least, one defends the instrument because one wishes to defend the objective (one may suspect that the objective itself may be under furtive attack). However, there are times when one has to stand back and ask whether the objective is still valid and, if so, whether the instrument is still capable of achieving that objective, and whether it remains the most cost-effective way. It is tempting but misguided to defend instruments which are ineffective or excessively expensive. To do so will damage the way in which subsequent history will judge the instruments which may have been valid and effective in their own time. Moreover, in the modern-day world, reliance on moribund instruments will provide ammunition to the anti-government populism which is now a significant force in many OECD countries.

Because public enterprise has been expected to serve so many purposes, determining whether or not it has been successful has always been problematic. Not only have there been multiple objectives but the weights attached to those objectives have shifted through time. Also, some of these objectives have been unmentionable — at times subsidizing inefficiency and protecting employment in sectors that, in economic terms, ought to contract. Whenever there is an instrument which is expected to deliver multiple objectives (e.g., efficiency, income redistribution, regional development and revenue generation), any comprehensive assessment has to measure the instrument against the full range of those objectives (Marchand et al., 1984). Exactly the same point is made by Becker (1985). I would certainly expect that in a lot of sectors, privatized firms would be more profitable (Megginson et al., 1994), but privatized firms will, within the regulatory constraints that have been set, pursue profit objectives much more aggressively. It is very important to recognize that efficiency is not the same as profitability, quite apart from the role, if any, of social equity objectives.

This is not the occasion to dwell upon problems of public enterprise control, but three comments constitute important background for what will be concluded later. First, if one consults the international literature, it is clear that many countries have had very similar problems in achieving a proper balance between enterprise autonomy and public accountability. I recollect reading a report from

the Economic Council of Canada (1986) which discussed this problem in colourful language:

The challenge of steering between the Scylla of inadequate commercial freedom and the Charybdis of weak public direction and control has confronted every country that has a significant government enterprise sector (p. 115).

I know that quotation very well, and have quoted it in my writing. While I have been in Canada, I came across it again, in a book chapter (Pawley, 1996: 301) on provincial Crowns by Howard Pawley, the former NDP premier of Manitoba. Such concerns are frequently voiced even by those who have a generally positive outlook towards public enterprises.

Second, the English-language literature has exhibited considerable admiration for the way in which the French system of public enterprise contracts seemed to have functioned more effectively than oversight systems in the English-speaking world (Garner 1976; Estrin and Perotin, 1987). Whether or not that was ever true — and it probably was for a period — there is evidence that it is no longer true (Nellis, 1988). Moreover, the financial conditions of *Crédit Lyonnais* and of *Air France* illustrate the scale of recent problems. Hood (1994) has written illuminatingly about the way in which control systems tend to auto-destruct.

Third, I came to the view in the 1980s that there were certain sectors in which public enterprises had traditionally been concentrated where more care would be needed in future (Heald, 1992). Specific examples were airlines (which have become much more exposed to international competition) and banks (which have moved from highly cartelized and relatively safe operations into much more risky businesses as a result of financial deregulation and property booms). Such changes in the habitats of public enterprises accentuate the traditional dilemma of wanting to combine entrepreneurial freedom for public managers with safeguards for propriety in the use of public funds and assets. My point is *not* that public enterprises are more likely to “misbehave” than private enterprises. In the financial sector, one only needs to look at the cases of *Barings* and *Deutsche Morgan Grenfell* to find examples of the private sector facing horrendous losses. However, the private-sector owners of financial institutions are typically highly diversified shareholders, whereas the impact of a major financial catastrophe on a single government, particularly a fairly small government, is much more serious. The budgetary cost and political fall-out from the spectacular collapses of the state banks in South Australia and Victoria illustrate this point (Gruen and Grattan, 1993).

This background strongly conditions my response when I read that public enterprises can no longer survive in the modern world on the basis of their domestic markets but must become global, or at least international. As soon as public enterprises move out of the markets that are understood by those who are responsible for their oversight, the risks to the public purse become substantially greater. When there is genuine substance to the argument that they need to expand overseas to remain competitive, then divestiture may well be the best option. Moreover, there are sometimes practical obstacles to such expansion: for example, I understand that there are complicated issues about Crown corporations competing elsewhere in Canada because of their exemption from federal income tax. Attempts by Saskatchewan Crowns to expand into the markets of other Canadian jurisdictions may lead to complaints of unfair competition.

## **SOME TENTATIVE SUGGESTIONS ABOUT SASKATCHEWAN**

The most important message I would draw from international experience is that the provincial government has to manage the process. This must be done while there are still policy options available because the danger of procrastinating is that, over time, the policy options will simply disappear. If policy decisions are not taken at the right time, you will obtain an extremely bad deal in terms of your remaining public-policy objectives. Following that through, serious consideration must be given to which of the policy objectives traditionally supported by the Crowns are still valid and which can be discarded. Then, with regard to continuing objectives, it is necessary to see whether the Crowns — or indeed any other instrument — can now deliver them. Crowns which have outlived their purposes should be divested or closed down. A failure to do so invites attacks both on continuing objectives and on Crowns with a remaining public purpose.

There are two issues which figure prominently in public concerns in Saskatchewan which are now discussed in turn. The first is about cross-subsidization and the second is about head office location.

### **Cross-Subsidization**

During recent work for the European Commission on policy towards cross-subsidy, I reached two conclusions (Heald, 1994a). The first was that a cross-subsidy is a lot easier to understand intuitively than it is to measure. When it comes to measuring a cross-subsidy, the methodology which is being used has to be probed carefully. I am now somewhat skeptical about many of the numbers which are cited in public debate. The second conclusion was prompted by recollections that, during the privatization of UK utilities, there had been a lot of discussion about serving rural areas and about cross-subsidy to rural areas. I was now struck by that fact that this had not, in fact, been a very important issue in the United Kingdom. People do care about universal service to Stornoway in the Western Isles of Scotland, but the truth is that only a very small proportion of the UK population live in the Scottish Highlands. In contrast, this is a much bigger issue for France, where many people live in large urban centres, yet there is a substantial rural population. I suspect, without knowing the figures, that Saskatchewan is a more extreme version of the situation in France.

Cross-subsidization has played a significant historical role in delivering universal service which has been both an emblem and practical manifestation of province building and nation building. Economists tend not to be comfortable with the idea of cross-subsidy, but cross-subsidy can be shown to have delivered certain social objectives which have been very highly valued by the community. What is very clear is that the sources of cross-subsidy will be competed away when there is deregulation and new entry. If the population is widely spread but there are several urban centres, new entrants will concentrate on the latter, take business away from the incumbent(s) and thereby compete away the source of the cross-subsidy that the incumbent has used to subsidize the rural area. That is the inevitable consequence of deregulation and has nothing to do with ownership change. Traditionally, the direction of cross-subsidy has been that the industrial and commercial sectors have subsidized the residential sector. Such a pattern will no longer be feasible because the source of the cross-subsidy will be competed away.

Moreover, there may be new concerns about cross-subsidy running in the opposite direction, especially when large consumers begin signing confidential deals.

In the modern world, where there is competition for jobs and new industry, it would not be a good signal to the rest of Canada and the world at large that Saskatchewan intended to keep restrictive telecommunications regulation as a means of maintaining traditional patterns of cross-subsidy. That is not to say that I am in any sense opposed to the objective of universal service. However, it is necessary to think very carefully about exactly what constitutes universal service; it may well be that in a deregulated world such continuing objectives have to be pursued by means of budget-financed rural telecommunications or rural electrification grants.

### **“Head Office” Jobs**

The second major issue concerns head office location, which is really shorthand for non-operational jobs. This figures prominently in all debates about the future of utilities in Saskatchewan, particularly due to the extent of local procurement by the Crowns. In Scotland, which like Saskatchewan is a peripheral economy, there are the headquarters of three significant privately owned banks and of some of the United Kingdom's most important life assurance companies. There are frequent tremors about hostile takeovers. Nothing is more guaranteed to bring out the Scottish lobby in force than a threat to one of these. Indeed, I remember in the 1980s, when the Clydesdale Bank was being taken over, that there was huge relief that it was bought by an Australian bank, not by an English bank. We are xenophobic in Scotland in a way that you seem to be paranoiac about Ottawa and Toronto! But it was not just xenophobia; an Australian bank would also need corporate headquarters in Scotland, which a London bank would not.

In the utility sector, which has been traditionally organized on a jurisdictional basis, enterprises are becoming much bigger. No one knows when or where the process of utility mergers, which has gathered seemingly unstoppable momentum in the United Kingdom, is going to finish. Where particular headquarters are located can be an almost accidental consequence of the sequencing of mergers. The point relevant to the Saskatchewan debate is that one is in a better position to get a good deal when bargaining from positions of strength. Negotiating from a position of weakness is to be avoided.

### **FACING UP TO DIFFICULT QUESTIONS**

It is very obvious from the public consultation process launched by TASC (1996) that there would be substantial public concern about and opposition to a proposal from the NDP government to sell a Crown. What I would wish to say to those of that view is that it is important not to rule out certain policy options solely on the grounds that they come with so much ideological baggage attached to them. In Saskatchewan, where there is a strong social democratic tradition, public enterprise has played an important role in the provincial economy. In Scandinavian countries like Sweden and Norway with equally strong social democratic traditions, there has been no comparable role. Paradoxically, some of the European countries with historically the largest public-enterprise sectors — notably France and Italy — owe them to right-wing governments.

The real question should always be whether chosen policy instruments deliver the objectives sought. One of the questions to be addressed now in Saskatchewan is what is the best way to serve the economic development objectives of the NDP government, while attempting to be clear about what is an instrument and what is a policy objective.

To offer a constructive criticism of the Crown corporations review (Crown Investments Corporation of Saskatchewan, 1996), I was surprised by the way in which it over-emphasized the question of ownership while neglecting the regulatory context. In fact, the mandate of the Canadian Radio-Television and Telecommunications Commission will extend to telecommunications in Saskatchewan next year. Moreover, the Agreement on Internal Trade will have regulatory implications for Crowns in the energy sector. The terms of third-party access are sometimes advantageous to the entrant, a feature which acquires particular salience in circumstances when the entrant is much larger than the incumbent. To repeat an earlier point, thinking about regulation is just as important as thinking about ownership. Whether public ownership works or whether privatization works can depend just as much on whether the competitive environment and the regulatory framework are right, as on anything else. Untold damage has been done worldwide to the image of public enterprise by its association with unnecessary monopoly, such positions having been protected when there were no longer good economic, technological or social reasons for doing so.

I presume that the consultants' reports have addressed the question about whether the five Crowns which have been studied are viable at their present scale of operation. Because they differ in character and operate in diverse markets, there is no reason why the answer will necessarily be the same for all five. I do not have enough information to express a view as to whether Saskatchewan should privatize some or all utility Crowns, other than to remark that — viewed from outside — they do seem exceptionally small in the modern world.

Assume, for the moment, that a decision has been taken to privatize a Crown. On that basis, there are two points made by Michael Walker (1997) this morning, with which I will concur before adding a third point. First, if you decide to sell a Crown, you should get the best price for that Crown, *conditional* upon securing those remaining policy objectives which are achievable. For a province with a big debt problem, it would be particularly important to realize the best price. A decade ago utility sales were novel but now there is extensive experience on the part of both merchant bankers and of those wishing to invest. I wrote in the late 1980s that popular capitalism was a public relations triumph for the Thatcher government in terms of smoothing the process of privatization, though it was empty of economic content other than being extremely costly in terms of foregone proceeds (Heald, 1989). While right about the first part, I did not fully appreciate that the regulatory framework for several privatizations would be so lax as a result of the concern to ensure that all new shareholders were on to a winner. For example, price increases in water and sewerage have been far higher than otherwise necessary, due to the deliberately lax price control adopted for the purpose of selling the privatization process politically. The agendas of certain UK regulators over the past decade have been dominated by efforts to repair the damage to

effective regulation done by earlier decisions motivated by these concerns to guarantee "successful" flotations.

Second, executive share options can be a useful mechanism in genuinely competitive sectors of the economy. However, executive share options in UK privatized companies have been thoroughly discredited by directors and managers deriving huge returns which had more to do with the structuring and terms of the privatization than with improved performance.

Third, if it were decided to privatize a utility Crown, the advantages of a direct sale to an industry purchaser rather than flotation on the stock market should be carefully explored. In terms of securing desired objectives (e.g., cash proceeds, commitments to universal service and employment protection), success is more likely if you keep control of the process in that way. I understand that SaskTel is an efficient enterprise, and that its problem relates to its small size in the modern world of telecommunications. If so, SaskTel may be worth much more now than it would be in the future. One of the reasons why an enterprise might be more valuable to a buyer than to its government owner is because it fits into a strategic whole. For example, a firm might be seeking a North American base and would be prepared to give employment guarantees or even to relocate other activities to your jurisdiction. In contrast, a rival potential buyer might wish to strip out all the "head office" jobs and provide such functions from elsewhere. There are dangers in cosy deals, such as the restricting of share ownership to people in the jurisdiction and by establishing a golden share to protect an enterprise from takeover. This can be a way of ensuring that citizens derive little benefit because the sales price will be depressed, quite apart from giving managers an easy life. Particularly, in relation to what I have heard about Manitoba Telecom Services, the chosen policy cannot release the constraints that are supposed to be the problem. If the problem is that MTS is not large enough, floating it as a separate company does not provide a solution.

## CONCLUSION

Good policy analysis and a willingness to face the world as it is are the best hopes we have for sustaining a vision of a good society. I am fully aware that some of the conclusions I have been drawing will not be welcome to some of my audience. My point is that objectives are most likely to be achieved when the approach is hard-headed and the pitfalls ahead are thought through.

The world economy has changed quite remarkably since 1973 and the OPEC oil crisis. The habitat changes have undoubtedly been hostile to the role of public enterprise in general, and have particularly narrowed the viable options for small nations and provinces. The long-term consequences of privatization and deregulation can only be assessed over a substantial period of time; the recent National Audit Office (1996) report on the UK's utility regulatory offices indicated that, even after ten years, there are many issues on which the verdict is still unclear. The World Bank, which initially championed public enterprise reforms, with privatization as an important component, now expresses unqualified enthusiasm for privatization, seemingly everywhere and of everything (World Bank, 1995). A considerable factor in this transformation seems to have been the international political situation after the collapse of the Eastern bloc, when mass privatization became a central part of the Bank's policy agenda.



Official sponsors of privatization should be more alert to the highly political, often unmentionable, objectives which are also features of privatization programs (Dobek, 1993). Nevertheless, the careful case studies of the Boston University team led by Leroy Jones have provided evidence in support of the net benefits of privatization in the enterprises they studied (Jones et al., 1990; Galal et al., 1994).

I will end my keynote address with two general observations, both connected to a growing unease about some of the social and political implications of a deregulated, globalized world. First, I recently heard a lecture in Edinburgh by Professor John Kay (Kay, 1996). His theme was "stakeholders," a term which presently has vogue status in the United Kingdom and one which has been picked up by the leader of the Labour Opposition. Kay's thesis was that private corporations owed responsibilities to a wide range of stakeholders beyond their shareholders. Ten years ago he had a reputation for being fairly hard-headed about the need for privatization and deregulation (Kay and Thompson, 1986). To my surprise, he compared very favourably the mission statement of the old ICI (which was somewhat paternalistic and not very internationally competitive) with the mission statement of the new ICI (which has been streamlined and is much more competitive in world markets). I found myself more in sympathy with the Edinburgh financial community critics of the old ICI, because I want private business to be internationally competitive, so that it generates jobs in my jurisdiction and pays its taxes. (One of the things which worries people throughout the European Union is that business is becoming rather skilful about not paying its taxes.)

What governments of the left or centre left should focus upon is maintaining their productive economy, making sure that it is sufficiently successful to generate the level of tax revenue which facilitates — through the budget and regulatory mechanisms — the achievement of public-policy objectives. Privatization is one policy option that any intelligent government would want to consider in the modern world. A decision taken at one particular moment to privatize one particular enterprise is not necessarily an indication of public enterprise failure. Quite possibly, changes in habitat may have removed the rationale for the continued existence of that enterprise.

Second, I reject the view that concern about growing inequality is sentimental stuff from the "old world." There is a lot of concern in Europe about trends to greater income inequality, trends which Atkinson et al. (1995) have shown to have been particularly pronounced in the United Kingdom. It is important to stress the message that countries which are to compete in the world economy need to make use of all their people, and that exclusion has economic as well as social and political costs.

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