FROM THE FRONT LINES

Making Privatization Work in South Africa and Africa

Leon Louw

From some reports the African National Congress (ANC) party, returned to power in South Africa's recent general election, will steer the country into another economic disaster in Africa. The new government is said to be bent on a destructive course of centralizing power, nationalizing mineral and water rights, terminating efficient outsourced services, intensifying censorship, violating the rule of law and the constitution, and interfering with financial markets. Further, according to these reports, it is politicizing the central bank, socializing health care, violating property rights, victimizing employers, curtailing the free press, implementing centrally planned "industrial clusters" and "development corridors," denying international patents, and more. It is alleged that under the ANC corruption, crime and unemployment have reached all-time highs.

Other observers, however, insist that the ANC has adopted high-growth, free market policies under the GEAR (Growth, Employment and Redistribution) program. They maintain that the stock market has reached record highs, agriculture and transport have been radically liberalized and privatized, tax rates lowered, restrictive laws deregulated, and democratic values upheld. These reports claim that hundreds of thousands of formerly homeless people have been housed (with water, electricity and other services), black living standards have risen without reducing South African whites' standards, state corporations are being commercialized and privatized, budget deficits have been slashed, government functions are being outsourced competitively, and subsidies are being cut. It is claimed that the civil service is being reduced, inflation is down, investment is up, small business is booming, and that there is unprecedented stability and racial harmony.

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The Free Market Foundation of Southern Africa

In South Africa more than elsewhere, commentators tend to predict one of two opposite scenarios: boom or bust. Both of these divergent views are an oversimplification. In truth, the ANC's economic policies and performance are neither clearly good nor bad. Economic policy remains relatively directionless. There is no detectable policy paradigm or philosophy. Instead, there is a random muddle of inconsistent and often contradictory policies.

In the wake of South Africa's recent general election, there are few indications of the direction, if any, South Africa is likely to follow under its new president, Thabo Mbeki. There are hints that President Mbeki might end labor policy excesses that have driven labor costs up and, consequently, unemployment to unprecedented levels (more than 25% of the labor force is now unemployed). During and after the election, the ANC recommitted itself to its promarket GEAR policy of privatization and small-business deregulation.

In direct contradiction, the ANC also recommitted itself to its anti-market RDP (Reconstruction and Development) policy, and announced the nationalization of mineral and water rights. The party has continued to implement draconian, unconstitutional consumer protection laws and upheld its reverse discrimination practices.

While analysts are waiting anxiously to see which path President Mbeki will take, the earliest indications are that he will not significantly change direction, or that he does not have any direction in mind. In short, the expectation is that most things will continue to improve slightly, while some will continue deteriorating under conditions of low growth and investment and high unemployment and crime.

Meanwhile, other African countries are increasingly moving towards free market policies. At the Corporate Council on Africa summit in Houston, Texas, in April of this year, many African leaders and senior officials were pledging new directions for Africa. African socialism, delegates were assured, is dead. These decision-makers foresee a new, investor-friendly Africa. Every few months another African nation holds its first democratic elections.

At a recent CIPE conference in Harare, Zimbabwe, various African speakers described the course of privatization/liberalization programs in their countries. It has become common for many African leaders to engage in a verbal contest about which nations are privatizing the fastest. Examples of this can be found in every issue of the growing number of African business magazines.

The many examples of this burgeoning privatization include water distribution in Angola; agro-industries, transport, mining, beverages, and tourism in Cameroon; more than a hundred private firms established in the Congo; palm oil industries in Cote d'Ivoire; electricity and water in Gabon; breweries, mines, resorts, and land in Mozambique; miscellaneous parastatals and government services in Kenya; game reserves, breweries, tour operations, and hotels in Tanzania; retail stores, flour mills and pharmaceutical companies in Lesotho; 11 state enterprises including chemical products, airports, and telecommunications in Mali; telecommunications in Mauritius; a new privatization program coinciding with democratization in Nigeria; 213 companies including telecommunications, hotels, airlines, banks, and coffee marketing in Uganda; and telecommunications, forestry industries, insurance, chemicals, engineering, refineries, publishing, hotels, and engineering in Zambia. By 1997 the World Bank had documented more than 2,700 privatizations in Africa. This figure is conservative, since the cumulative number listed for South Africa by 1996 (nine) is less than one-third of the number of privatizations that have occurred in the past three years in just one town, Welkom.

The numbers recorded by the World Bank for some African countries is impressive for such a short time period. They include Mozambique (548), Angola (331), Tanzania (244), Ghana (205), Zambia (183), and Kenya (145). For the first time since decolonization, most African countries are listing positive per capita growth rates (31 of 48 in 1996).

Moving towards Privatization

Privatization began in South Africa before it started elsewhere in the continent. Under the former apartheid regime in South Africa, for example, the privatization program included the iron, steel and petroleum industries, toll roads, agricultural marketing, and aspects of broadcasting and telecommunications.

More common than direct privatization is commercialization, corporatization and unbundling of state undertakings. There has also been substantial privatization at regional and local government levels. In the city of Welkom, for instance, over 30 municipal functions were privatized. The small town of St. Lucia outsourced almost everything to the point where it employed only two people: a town clerk and a secretary, who just negociate contracts with private providers.

During its early years, the ANC government suspended privatization, and spoke of renationalizing and reregulating what had been privatized and liberalized by its predecessors. But by 1996 privatization and liberalization was official ANC policy. Rather than reverse the privatization processes started by the former South African National Party, the ANC continued them, albeit after a quiescent period.

Track record

Railways and harbors. The South African Railways & Harbors Administration (SAR&H) was the country's biggest organization, second only to the government itself. Were it a company it would have been one of the biggest in the world. It included the country's railways, harbors, national airline, container depots, and much more—even its own statutory police force. As part of a lengthy 15-year process, SAR&H was transformed and, ultimately, dissolved.

The basic functions were unbundled, commercialized or corporatized into numerous subsidiaries, most of which fell under Transnet Limited, a state-owned company that changed from a bureaucratic state-run organization (South African Transport Services) into a dynamic group of businesses. Transnet and its subsidiaries are being privatized incrementally. Initially, a minority share is sold to a "strategic equity partner," a private company or consortium. This means that the day-to-day management is transferred to the "partner," which contributes new skills, finance and technology. In due course the remaining entity is privatized.

The former SAR&H monolith has been divided into seven major and a few lesser subsidiaries. Some activities were simply discontinued and left to private enterprise, such as airport buses, porters and catering. Some railway tracks and rolling stock (trains) were fully privatized, such as the narrow gauge Banana Express near Durban and the Apple Express near Port Elizabeth. Private trains are now also permitted on commercialized government tracks, the most significant of which is the internationally renowned Rovos Rail.

A 30% share in Transnet's fleet management services was privatized in a sale to Viamax Fleet Solutions, a consortium of private businesses, black "empowerment" interests and trade unions. After an open tender procedure, the new company secured the contract for the maintenance of 5,000 vehicles owned by Autonet, and is expanding into private sector fleet maintenance and management business.

Surplus railway land has been transferred to Propnet with a view toward exploiting the commercial potential of substantial amounts of surplus land through sale or development. Stations are being commercialized into profitable business centers. Engineering and technical services have been transferred to Protekon Ltd., which also envisions expansion by seeking private sector contracts.

The new state-owned and partly privatized companies have boards of directors drawn increasingly from the private sector. They must operate as other companies, as profitable business ventures, without subsidies or, in time, any privileges or protection. To this end, commercialization coincided with varying degrees of deregulation, including the admission to the market of private competitors, mainly in the form of alternative transport modes. The only subsidies that remain are for commuter services to historically black areas, on the grounds that they serve commuters who were forced by apartheid residential laws to live far from their places of employment and from business centers.

One of the most conspicuous successes of this policy has been the emergence of the Cape Town Waterfront. The Cape Town harbor was converted into a first-rate recreational and commercial tourist attraction, with a board of directors drawn largely from the private sector. Previously the area had only harbor facilities and one commercial restaurant. Now there are three leading hotels, one of the largest shopping malls in the southern hemisphere, theaters, night clubs, and numerous restaurants and entertainment areas.

The harbor company has increased commercialization in turn by outsourcing some activities such as security and maintenance, and is seeking privatization partners for its container handling and depots. The SAR&H police force, which policed railways, harbors and airports, has been dissolved. Some security functions have been outsourced, and the rest are administered by the national police service.

An important aspect of privatization has been liberalization and deregulation. The most visible example of this has been the emergence of a huge microbus industry competing with former government bus and rail monopolies. Within a decade there were 100,000 new black-owned microbuses, accounting for 300,000 jobs and one billion dollars worth of capital investment. This was achieved without affirmative action or financial assistance and in the face of continued harassment and restrictions.

In a recent statement the Minister for Public Enterprises, Stella Sigcau, the only woman to have been president of an African nation, announced that part of the national airline and two of the noncore assets, Connex and Transwerk, would be sold within 18 months. She expressed optimism that the pace of privatization would accelerate during 1999.

As a result of the successful commercialization of the South African railways, I was approached by the Kenyan government to consult on the restructuring of its railways. A similar approach as that of South Africa was adopted. In some respects, Kenya has overtaken South Africa, beating it at its own game. I also played a small role in the deregulation of Zambia's railways. Kenya and Zambia now allow private trains on government rails, much as private vehicles, planes and ships use government roads, airports and harbors.

Airlines. National airports in South

Africa were transferred to The Airports Company, 30% of which is being sold to Rome Airport Company, which provides the benefit of direct foreign investment. Among the more successful manifestations of airport commercialization has been the conversion of airports into profitable business ventures. Most of the airports have expanded and modernized. They no longer have restaurant, duty-free shopping or car rental monopoly franchises. Johannesburg International Airport has a commercial conference center.

A key issue is sequencing: Should privatization precede deregulation, follow it, or should they coincide? The conclusion seems to be that privatization before deregulation is the least desirable option. Among other things, it leads to monopoly abuse and conceals the potential benefits of privatization. Rather, privatization after deregulation is preferable because the entry of private competitors increases pressure for improved efficiencies and, ultimately, full privatization. Indeed, deregulation is a form of privatization because, to the extent that it allows private entry, there is a spontaneous transfer of market share to the private sector.

Local government. At the opposite end of the spectrum is the privatization of the fire service of the city of Benoni. This resulted not only in improved efficiencies and reduced costs, but in numerous innovations, such as the combination of ambulance services—also privatized—with fire services, and the utilization of the fire service's radio transmitters for cellular telephone purposes.

Universities. In response to reduced subsidies, government universities—previously a statutory monopoly—have been forced to outsource much of what they do. They have enjoyed cost savings with improved efficiencies. Simultaneously, private universities, mainly by way of distance learning programs, have successfully entered the market.

National orchestra. South Africa cut the National Symphony Orchestra's subsidies, and privatized it.

Successful Privatization Efforts in South Africa

	Accomplishment	*Impact*
Infrastructure	*Road construction, management and maintenance are privatized.*	• Private contractors develop BOOT system • Major investment in needed road construction • Improved transportation & increased commerce • Ownership of road system to be transferred to government in 25 years
Defense	*The national armaments industry, Armscor, is commercialized into a private entity, Denel, which in turn is unbundled into five subsidiaries.*	• Emergence of aviation, artillery, civilian products, information technology, & real estate sectors • Improved efficiencies • Reduced costs
Local government	*City of Benoni emergency services are privatized.*	• Improved response time • Reduced operational costs • Consolidation of ambulance and fire services • Fire service radio transmitters converted to cell phone use
Education	*Breakup of government monopoly on universities; some services are outsourced.*	• Increase in quality of education • Reduction in tuition costs • Rise in number of private universities • Competition from distance learning programs
National orchestra	*Subsidies are cut by government.*	• More frequent performances • Larger attendance and wider musical repertoire

Liberalization/deregulation

The privatization process is usually a matter of degree and context, seldom resulting in solely government or private entities. Much of South Africa's privatization, especially that which has benefited the masses directly, has been achieved without the direct disposal of a single state asset. Liberalization resulted in the emergence of various private alternatives to government activities, from transport and policing, to telecommunications and marketing. By merely allowing what was previously curtailed, privatization occurs spontaneously.

Instead of divestiture, government can simply discontinue a function it performs. When the local government bus service in Welkom was discontinued, for instance, within days private, owner-operated microbuses moved in to provide a more popular, efficient and affordable alternative.

Where government is unsuited for a particular activity or function and resources are no longer directed toward that activity, they should be privatized by the mere expedient of leaving them in the private sector by way of lower taxes. One of the most obvious examples is the abolition of influx control, whereby blacks were kept out of South African cities. Another was the scrapping of most forms of business licensing.

Upgrading land titles

Where government confers rights or privileges, such as government housing, franchises, or services management, it can privatize by upgrading those rights, ultimately to full ownership. Upgrading land title, in full or by degree, can be the greatest act of privatization that African governments can undertake. People who have government franchises—training or testing, for example—can be upgraded to full owners.

Outsourcing vs. sale

Outsourcing is probably the most common form of privatization, though it is not always recognized as such. In the South African context, in particular, outsourcing is one of the easiest and most effective ways to benefit emerging enterprises and historically disadvantaged people who live in various regions of the country.

Divestiture is not the most common form of privatization, but it is the most widely recognized. As with all methods of privatization, there are many ways to transfer state assets to the private sector: sale in whole or part, sale with or without a special voting right "golden share," sale by public offering or private placement, sale preceded by unbundling to smaller enterprises, management buyout, employee share option schemes, and so on—or any combination of these. There are countless variations on the privatization theme. The common element is that what was once done by the state is no longer done by it, even if it is no longer done at all.

Commercialization

Most protagonists of privatization would not expect state efficiency in areas more suited to privatization. Exceptions occur when commercialization is a prelude to fuller privatization. Commercialization is one of the degrees of privatization, and tends to yield commensurately modest benefits. In some South African case studies the benefits have been surprisingly substantial. The incentives of "full" commercialization simulate, although incompletely, positive private sector incentives, which are achieved when subsidies are cut unambiguously, private sector directors and/or managers are brought in and profits are allowed and encouraged—in short, when the undertaking is managed like a business venture.

Corporatization

Corporatization involves a more advanced degree of privatization, where the government concern is converted into a company. There are variations on this approach as well: the company can be anything from a nominal company—with continued government protection, subsidies, political interference, etc.—to a truly autonomous public company, perhaps listed on stock exchanges, with directors and management drawn entirely from the private sector, free from any political interference, and dividends paid to the owner.

For a time it was assumed that it would disappear. Instead, it now performs more frequently to more people. Subsidies had the effect of rewarding it for not playing music, at least not the type of concerts patrons wanted to hear.

Armaments. One of the unintended consequences of sanctions against apartheid was the government's development of a sophisticated nationalized armaments industry, Armscor. It was commercialized into Denel, and unbundled into five subsidiaries: aviation, artillery, civilian products, IT, and real estate.

Roads. Another successful South African privatization effort has been in the area of road construction, management and maintenance. There has been virtually no government investment in major road construction in recent years. Private contractors are now primarily responsible for road construction under the so-called BOOT system: build, own, operate, transfer. After 25 years or so, the private contractors will transfer the road system to the government.

Land. The South African government owns between a quarter and a third of all the country's land, and probably more if its value is taken into account. Most black people live on government owned land as tenants. An integral part of the government's land reform and housing policy is to transfer land to the homeless, and to upgrade tenancies to ownership. When and if the policy is implemented, there will be some 10 million new land owners in what will be one of the world's greatest acts of empowerment and privatization.

Lessons from South Africa

The standard literature on privatization tends to somewhat myopically reinforce the view that it entails the sale of assets by the state. The privatization discourse in South Africa, as in most African countries, confines itself to a discussion of the sale of large state undertakings—and how much profit the government can reap from such divestiture of assets. Specifically, it is often assumed that privatization transfers government monopolies to private conglomerates, thereby enriching a small elite class at the expense of the masses. This erroneous belief ignores not only the substantial mass benefits that flow from privatization in terms of even this limited conception that is so prevalent—and for which privatization advocates are partly to blame—but also the majority of actual privatization techniques.

Such confusion partly explains trade union opposition to privatization. Some South African trade unions are, however, developing a more sophisticated view of privatization. One of the largest and reputedly most radical unions, NEHAWU, for instance, is assisting its members to form enterprises to tender privatized services to former employers and others. NUM, the mineworkers union, has accepted privatization on condition that it benefits workers.

The box on page 36 outlines some of the means by which governments can implement privatization throughout their economies, with particular emphasis on the South African model.

Conclusions

Privatization in South Africa has been more successful than is generally recognized, even by its own government. It has taken place at all levels of government, especially the local level. And it has been established in many diverse forms not always regarded as privatization per se. Privatization in almost any form has been successful at achieving expenditure savings; increased efficiency; opportunities for entrepreneurs, disadvantaged people and elites; increased tax revenues; and net wealth creation, with accompanying growth and increased employment.

Ironically, the principal objection to privatization—expressed primarily by trade unions—demonstrates its superior benefits. The most common concern is that it will result in retrenchment of redundant employees. But if critics of privatization really believed what they claim—that governments can better perform privatized functions—they would predict increased inefficiency, and the need for more employees. This fear of critics of privatization amounts to an implicit concession that the private sector—under conditions of free competition and positive incentives—can do the same job with fewer people. In other words, it concedes that people are more productive in the private sector.

Efficiencies achieved by privatization amount to extra wealth in the economy. More wealth means more demand and, in turn, more jobs at higher incomes, even if not in the same undertaking. Privatization-induced unemployment is therefore transitional.

Finally, understanding the role played by incentives is the key to understanding why privatization works and to designing the optimal privatization strategy in each case. Privatization is an elaborate issue, but in the final analysis it provides profit incentives where government fails to and, consequently, increases national productivity and wealth.