PRIVATIZATION POSSIBILITIES AMONG PACIFIC ISLAND COUNTRIES

by

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EXECUTIVE SUMMARY

Two forces have combined to push privatization to the forefront of public debate: ideology and pragmatism. Ideologically driven enthusiasm is identified with the Reagan and Thatcher administrations, both strong advocates of free-market capitalism. But privatization appeals to a broader spectrum than ideologues of the right.

Irrespective of their position on the "socialist—mixed economy—pure market" continuum, leaders are questioning the efficiency of state owned or managed enterprises and are pondering the potential gains from privatization. The immediate attraction for many is the salutary effect that the selling-off of state assets promises for government budget deficits. However, quieter forms of privatization deserve close inspection as they are more relevant to small island economies. One method, contracting out, has found wide application in municipalities and cities in the metropolitan powers. Garbage collection, custodial services, street maintenance, and payroll preparation are a few of the traditional government services that have been transferred to private operators through a competitive bidding process. Studies indicate that, properly managed, such privatization actions produce gains in efficiency averaging between 20 and 25 percent.

Arguments in favor of privatization are not as clear-cut or convincing as propagandists would wish. At the worst, it substitutes insensitive privately owned monopolies for insensitive publicly owned ones and feeds corruption. Not everyone thinks that the exchange of money and property between private citizens and their governments is worthwhile. Any businessperson knows that selling assets to meet current spending is a path to bankruptcy. So what do governments do when they have nothing left to sell? Contracting out government begs the ancient political question: Who will watch the watchers? The efficiency of U.S. defense procurement—probably the most privatized portion of the American government—is hardly an advertisement for the superiority of privatization.
In a broad sense, any reduction in the role of the state will theoretically help the private sector and may thus be deemed "privatization." The key concept is increasing the role of market forces. Many measures can contribute to this, notably freeing of entry to an industry, encouraging competition, and permitting joint ventures. So can restructuring a nationalized industry, contracting for service delivery, or reducing subsidies. Generally speaking, four components encompass the range of public-to-private shifts. These are privatization of finance, privatization of production, denationalization, and liberalization.

The formative years of the island states' nationhood were characterized by a great faith in the power of public policy to steer a proper course toward economic development. The publicly owned corporation became a favored tool in the industrial organization of island economies. Governments cite a wide variety of reasons for creating state-owned enterprises (SOEs), which can be classified as economic, historical/neocolonial, sociopolitical, and nationalistic. The extent to which the original circumstances and reasons remain valid today largely determines the costs and benefits of privatization.

Despite the abundance of "good" reasons for direct state control of enterprise, it must be admitted that the performance of SOEs has been disappointing. When measured in financial profitability terms, most SOEs surveyed worldwide show returns lower than the going market rate of interest, reflecting waste and a misallocation of resources. However, when evaluated by social benefit-cost criteria, these same loss-making enterprises may be found socially profitable. The record of SOEs in achieving distributional goals is mixed and inconclusive.

An important public policy debate is whether enterprise efficiency is fundamentally determined by ownership (public vs. private) or by market structure (competitive vs. non-competitive). If it is accepted that competition has a greater impact on efficiency than does ownership, then there is little to recommend in a policy that replaces monopolist state enterprises with monopolist private firms. On the other hand, if a sole government producer is replaced by an actively competitive environment, a "bigger pie" results, which can be distributed equitably through the state's powers of taxation and transfer.
Privatization decisions are complex, and it is helpful to structure the problem as a benefit-cost analysis. In principle, the government can list the benefits and costs of each proposed privatization action, quantifying the anticipated impacts as far as possible. Some trade-offs respecting the interests of various groups are inevitable. On economic efficiency grounds, highest priority should be accorded to effects on the consuming public.

While privatization decisions must be approached on an individual basis, governments should institute a comprehensive review and implementation system covering the range of government functions. It is important that the government have a clear idea before embarking on privatization as to what its objectives for the program are and why it is undertaking it. Governments may not always find it politically desirable to enunciate these publicly and in detail, as any one of them may alienate some faction in their constituency. The relative priority attached to each objective ought to be settled, however, because there will be occasions when they point in quite different directions.

American Samoa is a relative forerunner in the Pacific in the privatization process. The political commitment of the current administration to privatization is strong, and the approach is systematic and well organized. While budgetary circumstances in the American entities impose strong incentives for privatization, interest throughout the Pacific runs high. The collective experience of the islands suggests numerous future privatization possibilities. However, the size and isolation of Pacific island economies present serious constraints to the degree and type of privatization actions that may be attempted. These constraints include the small size of the private sector, difficulty in raising investment capital from domestic sources, concentration of domestic private capital and entrepreneurial expertise, and underdeveloped fiscal systems.

The islands' private sector can play an important role by showing an interest in potential privatization and in putting forward bids. Governments need to be convinced that there is a reasonable level of interest in the operations being privatized before they are prepared to start the privatization process. Misunderstandings can be reduced through the establishment of a private sector-public sector dialogue. These discussions might help bridge the
wide gaps that presently exist between governments and businesses in the Pacific.

The privatization path is long and twisting, and island governments must avoid the temptation to rush the journey. Although economic forces may prompt it, privatization is fundamentally a political decision. Measures of efficiency and equity are the sometimes conflicting economic yardsticks of the gains and losses from privatization. Governments will find it easier to reconcile these conflicts if their privatization objectives are clear from the outset. In addition, privatization plans will be easier to digest if they contain multiple options for political decision makers. The Pacific business community can assist in defining the feasible range of options.

Full divestiture is unlikely to be widely adopted in the Pacific for reasons of loss of control and concentration of wealth. Other options exist, but economic liberalization and the promotion of competition should be components of any privatization strategy. Above all, privatization decisions must be considered on a case-by-case basis. Exhortations of the ideological right, and naysaying of the ideological left, have little place in the pragmatic, consensus-seeking Pacific.
INTRODUCTION

If the explosion of interest over the past two or three years is any guide, then "privatization" can be termed the latest public policy fad. Yet tensions between public and private production and provision of goods and services have existed since post-feudal England and the institution of private property. Of late, however, two forces have combined to push privatization to the forefront of public debate: ideology and pragmatism.

The source of the ideologically driven enthusiasm is easy enough to identify. Both the Reagan and Thatcher governments are strong advocates of free market capitalism and believers in the "magic of the marketplace." Backing up this faith in the impartial munificence of the invisible hand is a desire to reduce the role and influence of government in the everyday lives of the citizenry. And clearly, "getting government off the backs of business" is squarely on the agenda of these conservative administrations.

But privatization appeals to a broader spectrum than ideologues of the right. Irrespective of their position on the "socialist—mixed economy—pure market" continuum, leaders are questioning the efficiency of state owned or managed enterprises and are pondering potential gains from privatization. The immediate attraction for many is the salutary effect that privatization promises for government budget deficits. In one type of privatization, state assets are sold off to buyers in the private sector; the cash infusion thus fattens government coffers. In addition, a shrinking public sector means lower subsidies with consequent lower taxes and decreased "crowding-out" of private sector borrowing requirements. The place of this approach in popular thought is illustrated by a recent cartoon appearing in the New York Daily News. Two burly lawmakers are talking while descending the steps of Capitol Hill. "To lower the deficit," one turns to the other and says, "Reagan's selling off a few government assets." Retorts his colleague: "Well, that leaves us out."¹ In another jest, one wag
suggests that, in lieu of plans to divest British Airways, the Thatcher government should allow the RAF to be bought out instead. The motto for the new airline is expected to be "You better like us."  

While government fire sales seem to attract media attention and glamour, quieter forms of privatization also deserve close inspection, as they are more relevant to small island economies. One method, contracting out, has found wide application in municipalities and cities in the metropolitan powers. Garbage collection, custodial services, street maintenance, payroll preparation, and even the operation of airport control towers and prisons are a few of the traditional government services transferred to private operators through a competitive bidding process.

Indeed, it seems like everyone is doing it, although differently. Britain's telephone system is now in private hands, as is Jaguar Motors, the National Freight Corporation, BritRail hotels, the North Sea oilfields (51 percent), and British Aerospace. Soon to go up on the block are the gas system, major airports, and the aero-engine division of Rolls Royce. In France, in a virtual volte-face, the newly elected conservative government plans a clearance sale whose value exceeds the English denationalization. Among the pieces of the patrimoine national to be put in the window are the three giant state banks (Société Générale, Banque National de Paris, and Crédit Lyonnais), half a dozen big industrial groups, Air France, and two of the three state television stations.

Closer to home, Japan's government expects to get almost US$40 billion from the partial sale of Nippon Telegraph and Telephone. Singapore has raised $240 million by selling a minority share of its airline; a similar share offering of the Malaysian Airline System was 6.6 times oversubscribed. The Philippine government would like to unload a substantial portion of its 248 (mostly loss-making) corporations. Finding buyers other than business friends of ex-President Marcos is problematic, however. Recently, the New Zealand government announced plans to open up commercial banking to just about anyone with adequate capital—a move that will end the official control of banking by four banks. The treasury has recommended selling off the rights to the radio and television broadcast spectrum. The current finance minister
Privatization Possibilities

has called New Zealand's proliferating subsidies "a national pastime."\(^5\)

Lest we be swept away by the privatization wave, bear in mind that the arguments in its favor are not as clear-cut or convincing as propagandists would wish. At its worst, it substitutes insensitive privately owned monopolies for insensitive publicly owned ones and feeds corruption. Not everyone thinks the exchange of money and property between private citizens and their governments is worthwhile. As elegantly summed up by Harold Macmillan, Britain's Conservative Prime Minister from 1957 to 1963: "First of all the Georgian silver goes, and then all that nice furniture that used to be in the salon. Then the Canalettos go."\(^6\) Any businessman knows that selling assets to meet current spending is a path to bankruptcy. As the *Economist* points out, what do governments do when they have nothing left to sell? Contracting out government begs the ancient political question: Who will watch the watchers? The inefficiency of U.S. defense procurement—probably the most privatized portion of the American government—is hardly an advertisement for the superiority of privatization.\(^7\)

The privatization issue demands a set of compromises between two incompatible notions of political equality—one-person-one-vote—and economic equality—one-dollar-one-vote.\(^8\) This paper attempts to clarify these compromises by first defining privatization and its economic justifications. A look will then be taken at the various rationales for the original creation of state-owned enterprises (SOEs), which in the developing world were mostly launched after World War II. The extent to which these circumstances and reasons remain valid today largely determines the benefits and costs of privatization. Through generalization of the preceding discussions, the paper outlines bases for decision making and presents an overview of the implementation process. Possibilities for privatization of certain Pacific island government functions will be noted, along with special considerations relevant to small island economies. Last, mention will be made of the role of the Pacific business community in privatization.
WHAT IS PRIVATIZATION?

The British spell privatization with an “s” and have perhaps the most smug definition: “Privatisation is a process which transfers ownership and control of a state asset to the private sector.” But this definition is too limited for our purposes. Even if the primary concern is with asset transfer, most governments choosing this route are selling off only minority stakes in the assets they own. Whether their reasons are political caution, a lack of local capital, or a simple wish to raise money without surrendering control, they still call their actions privatization. Furthermore, as foreshadowed in the introduction, many forms of privatization do not involve the sale or transfer of state assets.

In a broader sense, any reduction in the role of the state will theoretically help the private sector and thus may be deemed “privatization.” The key concept is increasing the role of market forces. Many measures can contribute to this, notably freeing of entry to an industry, encouraging competition, and permitting joint ventures. So can restructuring a nationalized industry, contracting for service delivery, or reducing subsidies.

To repeat, the characteristic feature of this broadly defined privatization is the substitution of market systems of allocation for non-market systems. The institutions collectively described as the “state” or the “government” are the major, but not the sole, mechanism for the non-market allocation of goods and services. An important non-market system in the Pacific is the voluntary or charitable sector. Indeed, an important element in any privatization policy is to ensure that the encouragement of the private sector does not result in undue stifling of voluntary efforts and the displacement of this vital social dynamic. This caveat rendered, the focus will henceforth be on the four components that encompass the range of public-to-private shifts. These are privatization of finance, privatization of production, denationalization, and liberalization.
Privatization Possibilities

Privatization of Finance
It is important to regard the switching of the source of financing for a good or service from taxation to user charges as a component of privatization. In general, public services are financed by taxation, and public enterprises are self-financing through charges. In practice, the dividing line is fuzzy, and subsidized hybrids are common. Governments may decide to levy user fees in lieu of taxation for reasons of reduction of deficits, decreased wastage in consumption, or recognition of "freedom of choice." One thing that is clear is that the method of finance has a profound effect on the types of institutions that can operate, and a strong link exists between reducing dependence on tax financing and opening up opportunities for other forms of privatization.

Privatization of Production
The second component of privatization involves the privatization of production without privatizing finance. (If both were privatized, we would have the pure private market.) Depending on the type of good or service to be provided, such production can take a number of forms:

- Contract—The substitution of privately organized contract labor for public employee labor is the most common form of private production. The contracts are generally awarded via a competitive tendering process.
- Franchise—This form of production involves the awarding of a privilege (which may be exclusive) to provide services in a particular sector or geographic area. Operations permits may be made on a bid basis or under a fixed-fee/licensing arrangement. Examples include the sale of oil drilling rights, the licensing of television stations to the private sector, or the franchised supply of electricity. Suppliers may tend to monopolistic behavior unless award periods are appropriately short.
- Lease-out—For reasons of control and political risk avoidance, the government may wish to lease state-owned facilities to private operators. Thus the capital cost of service is partially public financed, while the operations costs are privately financed. A ship repair facility, for example,
may be leased to the highest bidder who may then pro-
vide repair services to the government fleet under a ser-
vice contract arrangement and to private boat owners on
a fee-for-service schedule.

- Management contract—Contracting for managerial services
from the private sector may be appropriate if the required
skills are highly specialized or not available within govern-
ment. The procedure blends some of the discipline of pri-
vate supply with the retention of assets on the public side.
This arrangement is commonly seen in the operation of na-
tional airlines.

- Voucher—This is a form of public finance in which taxpay-
ers/consumers are provided with a ticket that may be ex-
changed for a pre-determined amount of goods or services
produced by the private sector. The GI Bill for the educa-
tion of demobilized American soldiers after World War II
stands out as the most successful voucher scheme in U.S.
history. Vouchers often take the form of a grant subsidy to
the poor to enable them to pay market prices for neces-
sary goods and services. The American food stamp system
is perhaps the preeminent example of the latter.

The distinctions between public and private finance and
production may be summarized in tabular format as follows:

**TABLE 1. Modes of finance and production**

<table>
<thead>
<tr>
<th>FINANCE</th>
<th>Public</th>
<th>Private</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public</td>
<td>Taxation (Public services)</td>
<td>User fees (Public enterprises)</td>
</tr>
<tr>
<td>Private</td>
<td>Contracts</td>
<td>Private market (includes divestiture and load-shedding)</td>
</tr>
<tr>
<td></td>
<td>Franchises</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Lease-out</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Vouchers</td>
<td></td>
</tr>
</tbody>
</table>
Denationalization and Load-shedding

Denationalization is the reverse process of nationalizing a firm or industry. The term is used interchangeably with “divestiture” or “ownership transfer.” Unfortunately, public debate has tended to substitute the all-embracing term “privatization” when reference is intended to the sell-off of public enterprises. The taxonomy of divestiture includes:

- Selling off the whole—In this case, the whole of a specific government operation is sold as a unit. This method is most suitable for relatively small organizations dealing with a specialized product or service. The entity may be sold to the public through a stock offering, sold to the workforce, or exchanged for cash in a private transaction. Some British economists advocate the give-away of stock in an SOE; nebulous interests in the national wealth are thereby exchanged for specific, tradable fractions.

- Selling complete parts of the whole—Even where the whole of a public operation cannot be sold, there are instances in which distinct sections may be sold off independently. To illustrate, a government may wish to privatize a state-owned tourist hotel but not the national airline that manages it. A single private buyer could be sought for the hotel.

- Selling a proportion of the whole operation—National sovereignty and control considerations have led many LDC governments to bypass full divestiture in favor of allowing private parties to buy in on a state business. The government may choose to hold a majority or minority equity position through the percentage of stock shares retained or by the terms of the joint venture agreement with a private partner.

- Liquidation—If it is determined that demand for a product or service no longer exists or that public provision is no longer justified, the state may choose to liquidate the assets of the SOE. The unitary integrity of the organization is not preserved in this asset sell-off process.

Closely related to liquidation is “load-shedding” or the cessation of government provision of particular goods and services. Withdrawal from the market will oftentimes induce supply by
the private sector or by voluntary organizations. In this case, government assets may then be reassigned to other tasks. Education and health care services are supplied to a significant degree by non-governmental means in many countries.

**Liberalization**
This fourth component is held by some to be not a part of privatization at all. If, however, liberalization is viewed as the step toward a more market-oriented economy, it will be seen as an essential component of privatization. As will be re-emphasized in this paper, little is to be gained in terms of efficiency if a service contract is to be awarded to the sole and only potential bidder. Neither will economic gain result if an SOE is sold to the same monopoly capitalists whose existence prompted nationalization in the first place. Liberalization as applied to privatization is thus the freeing of competitive forces within an economy and the creation of economic conditions that enable the private sector to coexist on a more or less equal footing with the public sector. Main elements of a liberalization strategy are briefly enumerated below, although proper treatment of the issues would necessitate a separate and full-length discourse.

- **Deregulation**—Prohibitions and controls on various fields of enterprise and competitive behavior are removed. Deregulation is often spurred by technological change, as in the U.S. long distance telephone market, where privately owned satellite and microwave links have given rise to free competition.
- "**Break-up**"—Existing public enterprises are split up along functional or territorial lines. Again, technical progress may change the size range in which economies of scale are captured and open the way for public-private competition. A simulated competition may result through comparison of the performance of geographically separated SOEs.
- **Substitution of ex-ante for ex-post SOE subsidies**—Many SOEs receive a year-end subsidy injection sufficient to cover their losses. This practice discourages business-like pricing and management. Subsidies should be determined on the basis of the audited impact of non-commercial services offered by the SOE (e.g., low demand internal air routes).
Privatization Possibilities

- Relaxation of industrial and import licensing requirements—Often justified through avoidance-of-duplication arguments, the licenses may effectively bar entry of competing firms. The “first come, first served” predilection of government licensing bureaucracies entrenches inefficient monopoly/oligopoly enterprise.

- Relaxation of exchange controls—Currency exchange controls insulate domestic industry from world market competition. Exchange allocations tend to be distributed on a “first in” basis, similar to licenses.

- Reduction of tariff barriers—The logic of protected domestic industry operating behind tariff walls is often based on infant industry considerations. Unfortunately, if tariff protection is not removed in a timely fashion, the infant may grow up to become a monopolist.

- Tax reform—Business tax rates so high as to be considered confiscatory are an obvious dampener of entrepreneurial enthusiasm.

- Price decontrol—Prices set low to benefit consumers are a disincentive to private production. Similarly, competition may be a more effective form of monopoly counter than price regulation. In the factor market, credit allocation schemes and subsidized interest rates for SOEs may work in an anti-competitive fashion.

- Strengthening of legal protection of private property—Some LDC legal systems lack adequate guarantees of property rights, mechanisms for contract enforcement, and provisions for dispute resolution. The extent to which these protections are faulty provides a disguised disincentive to the private sector.

- Reduction of red tape—“One-stop” agencies help to centralize and simplify industry’s contacts with government. An alternative and amusing but effective approach to the red tape problem is Brazil’s creation of a Ministry of Debureaucratization to cut down on regulations and licensing. Savings in that country to date are estimated by the World Bank at more than $1 billion.\textsuperscript{11}

Liberalization can be viewed as a natural phase in the evolution of a mixed economy. In the early stages, the indigenous pri-
The private sector consists largely of subsistence farmers and small family trading enterprises, while the modern sector is dominated by largely foreign-owned enclave industries such as plantation agriculture and mining. Under these circumstances, governments feel that they must take the lead in organizing the country's productive resources in state corporations, both to compensate for private sector weaknesses and to balance expatriate interests. Later, as the economy changes, so does the role of the state. The occupation of governments becomes less with directing and controlling and more with regulating and rectifying failures of the marketplace. The place of state-owned enterprises, both past and present, is briefly examined in the next section.
THE ROLE OF STATE-OWNED ENTERPRISE

In common with developing Africa and parts of Asia, the Pacific was (or is) one of the last regions of the world to emerge from colonialism. The formative years of the island states' nationhood, the 1950s and '60s, were characterized by a great faith in the power of public policy to steer a proper course toward economic development. The publicly owned corporation became a favored tool in the industrial organization of island economies. Figures gathered by the International Monetary Fund (IMF) show that developing country SOEs presently contribute about 7-15 percent of GDP and account for 25-60 percent of fixed capital investment. While statistical data are lacking, evidence suggests that the role of SOEs in the Pacific is at least as large as in the rest of the developing world. Trebilcock provides the following sketch of the Papua New Guinea government as entrepreneur:

The central government has direct interests in 34 enterprises (a 49 percent or greater interest in 28 of them), and indirect controlling interests in another 23 companies through the Development Bank and the Investment Corporation, both of which it totally owns. The Investment Corporation has investments in a total of about 53 local enterprises, most of these investments being minority portfolio holdings. In addition, the Investment Corporation has substantial investments in various real estate projects. At the provincial level, all 19 provincial governments have formed provincial development corporations.

A list of Papua New Guinea government direct commercial investments and indirect controlling shareholdings is appended to this paper.

Governments cite a wide variety of reasons for creating SOEs, ranging from ideological to pragmatic. These rationales can be further broken down as economic, historical/neocolonial, sociopolitical, and nationalistic.
Economic factors are principally concerned with "market failure," or those violations of the assumptions of neoclassical economics that corrupt the workings of the "invisible hand." The existence of "natural monopoly" conditions violates assumptions of perfect competition and gives rise to calls for public enterprise. It is argued that a firm will become a natural monopoly if the (average) cost of producing a product constantly declines as output is increased. Each firm in the marketplace will be inclined to cut its price in order to increase its market share and reduce average costs. Economic warfare will result and there will be only one survivor—a natural monopolist. As in any monopoly situation, it follows that the natural monopolist will raise prices and restrict output once it establishes itself, and this leads to excess profits and economic waste. The occurrence of natural monopoly is essentially a physical-technological phenomenon having relation to the feasibility of duplication of infrastructure. Electric power transmission and local telephone services are considered natural monopolies, whereas long-distance dialing is not. The traditional method of control over the natural monopolist is regulation through return on investment or "cost plus" criteria. Another alternative, of course, is to let the state step in and supply the market by employing a single public enterprise. Price and output can thus be set to eliminate consumer exploitation, or at least the surpluses can flow to the government instead of the private capitalist.

Economic theory predicts that "public goods" will be undersupplied by the private market. A public good is a product or service that, once supplied, can be consumed by any person without diminishing the ability of others to also enjoy it. The classic example is the lighthouse. Every passing ship can benefit, and there is no way to restrict access to the guiding light or force payment from users. Private entrepreneurs will thus be bankrupted, and the state winds up as supplier. A true-to-life public good is educational TV.

Another type of market failure is the problem of "externalities." An externality exists when third parties are affected in a manner that is not taken into account in the transaction between buyer and seller. Say a beer brewery is located downstream from
a fertilizer factory. Water from the factory-polluted stream has to be purified before use in fermentation, imposing extra costs on the brewer and raising the price of beer. Yet the farmers pay the same price for fertilizer with or without the factory's pollution. Economists would say that too much fertilizer, and not enough beer, is being produced! One solution is to levy a tax on the fertilizer plant based on the volume of water it pollutes. Another is to let the state own both the factory and the brewery. That way all costs of fertilizer production, including pollution, will automatically be "internalized" or accounted for in production decisions. A similar line of reasoning holds for the need for public schools. Benefits of education (e.g., lower crime) accrue to society as a whole, but the student will be willing to pay only in proportion to the increased earning power and prestige gained from schooling. Transactions between private schools and students will therefore result in education being undersupplied relative to its social worth.

Still another type of market failure is known as private risk aversion or the "lumpiness of capital" argument. Certain types of large, fixed capital investments have an "all or nothing" character and cannot be approached incrementally. The potential losses to a single investor or even to a consortium of investors may be greater than what is considered tolerable. If the state nonetheless considers the project suitable for funding, it effectively spreads the risk among the entire citizenry and thus overcomes private risk aversion.

Related to the reduction of risk and uncertainty is the desire, in some LDCs, to attract or retain foreign investment. As a co-investor or joint venture partner, the government acts to reduce fears of expropriation.

A final form of market failure occurs on a global market scale. It is held that a domestic monopoly is sometimes necessary to counteract the power of foreign monopolies and unfair international trade practices (e.g., subsidized foreign industries, dumping, and cartelization). And if a monopoly is to be created, better to put it in public than private hands.

Other economic justifications for state-owned enterprise are mainly grounded on convenience factors. Governments wishing to intervene in the agriculture product market find government
marketing boards to be a handy means of price control, stabilization, or export taxation. Last, any state enterprise that manages to extract a true profit bolsters government revenues.

**Historical/Neocolonial**

Characteristics of a country's development history provide important rationales for the establishment of SOEs. These justifications are employed by both colonial and post-colonial administrators.

First is an adjudged lack of entrepreneurial/managerial skills in the private sector. Of course, one does not have to be a inveterate skeptic to question whether there is a greater likelihood of these skills being found in government. Related is the desire for government to set a modernization example for the emerging private sector. Rare is the LDC without a “showcase” project (often externally financed) stuffed with the latest technology. Rarer still is such technology found to be appropriate, cost-effective, or properly maintained.

A serious impediment to greater private ownership of the means of production in LDCs is the lack of investment capital in private hands. Well-organized capital markets exist only in the most sophisticated of the developing market economies, and the workings of stock ownership remain a mystery to the vast majority of Third World populations.

**Sociopolitical**

Whereas neoclassical economics has a great deal to say about organizing for economic efficiency, i.e., making a bigger pie, it is comparatively silent on how the pie is to be divided. Questions of distribution and equity do not lend themselves to scientific analysis and are fundamentally the province of political thought. Many decisions to create SOEs embody implicit tradeoffs of private sector efficiency for the distributional control afforded by public enterprise.

The theme of distributional justice takes many forms. The SOE may be used as a device for reducing income inequality, often through the provision of necessities at subsidized prices. Regional economic development may be promoted and geographic disparity alleviated by locating SOEs in underdeveloped areas.
By making "public" enterprise public, political forces attempt to counterbalance the power of domestic capitalists. The process may, of course, befit the ideological aims of socialism.

Provision of employment and training to the marginally employable is cited as a compelling motive for the creation of SOEs. Besides providing a stabilizing reservoir of jobs, political ends are served as well. In many countries of the Pacific, for instance, government wages appreciably lead private sector pay. Given the large numbers on the public payroll, a government-financed middle class is created with attendant loyalties at election time. Another political benefit associated with SOEs is the appearance of action and resolve lent to a politician who proposes to institute one. In the public eye, the government is seen to be "doing something" about a problem.

Nationalistic
Appeals to national self-identification and enhancement of national prestige constitute a final class of reasons for the formation of public enterprise. Often the content of the agenda is obscured by references to self-sufficiency or self-reliance. Perhaps a more legitimate concern addressed by SOEs is the promotion of national security. A public energy, mining, or manufacturing enterprise can assure access or security of supply of strategic materiel during time of warfare, for example. A more likely mi preserving raison d'être in Pacific island states is the perceived need to offset the power of multinationals. Only the state, it seems, can marshal labor and capital on a scale even approaching that possessed by MNCs. Many multinationals are positioned to operate in the resource and capital intensive "commanding heights" sectors of the economy, which are precisely those most often targeted for state control.
ON THE BENEFICENCE OF COMPETITION AND GREED

Despite the above listing of about 25 good reasons for direct state control of enterprise, it must be admitted that the performance of SOEs has been disappointing. In this section, a quick look will be taken at the indicators of public enterprise performance and the causes of shortfalls vis-à-vis the high expectations fostered in the 1950-1970 "development decades." The more interesting and relevant question—Can the alternative (private enterprise) do any better?—will also be addressed. If the answer is in the affirmative, then planners may have erred too far on the side of state intervention, raising possibilities for privatization.

Failures of SOEs and Public Policy

To the businessperson, the most important measure of enterprise achievement is the last entry on the profit and loss statement. The World Bank has surveyed the financial performance of SOEs worldwide and found that rates of return on investment ranged from negative to about 10 percent. In nearly all cases, the returns were lower than the going market rate of interest. Economists are fond of terming loss-makers as "failures to effectively mobilize resources" and couch their judgments in phrases like the following:

Contribution to resource mobilization was generally negligible or negative because of increasing claims on budgetary resources as operating losses mounted with the deterioration in the financial position of some public enterprises due to structural inefficiencies (Personal communication, February 24, 1986).

Few figures on rates of return of Pacific public enterprises are available. However, the IMF analyzed the ROR (rate of return) realized by the Papua New Guinea Electricity Commission, the Harbours Board, Post Telecommunication, and Air Niugini, on net total assets for the period 1973-77 and found that the rate varied from about 4 percent for the Harbours Board to 9 percent
Privatization Possibilities

for P & T. This compares with an estimated opportunity cost of capital of about 15 percent after tax.\(^\text{17}\)

Wasteful application of resources manifests itself in other ways besides poor profitability. Problematic SOEs drag on policymakers' time, make large and growing claims on the government budget, which must be financed by higher taxes or greater borrowing from domestic and foreign sources, and divert funds from more profitable investments. The commonly observed overstaffing of state corporations is another symptom of misallocation of resources.

Failures of SOEs to operate in a business-like manner may be further isolated by comparison with private sector practices. Government fund accounting systems retained by SOEs improperly value capital assets and fail to make proper allowances for capital replacement at current prices. It is as if the opportunity cost of capital were free. One result is inadequate maintenance and high consumption of capital. Other accounting system weaknesses surface in hidden subsidies and ignored overhead costs and are reflected in underpriced outputs.

Generally speaking, SOEs have not fared much better as investors and marketers. SOEs often fail to adequately assess consumer demand; the type of product or level of service is simply ordained. Not surprisingly, SOEs have not proved particularly competent at forecasting future cash flows from the entry into new markets. Thus, investment analysis of new projects proceeds on an inadequate knowledge base. Risk analysis, the darling of "smart" private enterprise, is virtually ignored through misapplication of the "spreading of risk" principle.

The foregoing attack notwithstanding, it is important to bear in mind that strict financial criteria are not always valid efficiency indicators. Economic (as opposed to financial) performance may be evaluated by social benefit-cost analysis. The methodology is complex and controversial and suffers from no lack of detractors. However, the importance of the technique can be highlighted by noting that the development banks, which interface with the international commercial capital markets, insist on an economic analysis of nearly every developing country loan opportunity.

Basically, economic analysis attempts to correct for the distortions frequently found in LDC economies. Such distortions
may take the form of a tax, subsidy, exchange control, or wage policy (to name but a few), but have the effect of driving a wedge between market prices and true values (opportunity costs). A state-owned oil company, for example, may be directed to sell petroleum products to domestic consumers at below world market prices for political reasons. An economic analysis would credit oil company revenues for this difference, thereby improving the profitability picture.

Another type of "distortion," not usually accounted for in either financial or economic analysis, is the revenue loss associated with government-dictated non-commercial operations. Utility organizations, for instance, may be prohibited from engaging in price discrimination—charging different consumer classes different prices to maximize revenue—a practice engaged in by every large investor-owned utility. In the airline industry, unprofitable routes may be flown for the convenience of government or travelers. To the extent that these losses can be explicitly identified, measurements of efficiency can be adjusted. However, an SOE with a "transparent" set of financial statements is exceptional.

When SOEs play on a level field, the conclusions of inefficiency derived from financial analysis are not necessarily repeated. Indeed, the World Bank reappraised the aforementioned loss-making SOEs using economic criteria and found the majority to be socially profitable.¹⁸

Equity criteria constitute yet another yardstick of SOE performance. The record of SOEs in achieving distributional goals is mixed and inconclusive for at least two reasons. First, consumers of SOE outputs may be large industrial users or the wealthy, not the poor. This is especially true if the product is an intermediate good in the production chain. In this case, the SOE may function as a form of subsidy to well-off private industrialists. Second, across-the-board subsidies typically offered by state utility firms have perverse distributional consequences. Poor energy consumers do receive a subsidy, but rich, high-consuming customers receive a greater effective subsidy.

Causes of SOE Failures
The causes of the poor performance of SOEs have been a recent favorite topic for study by development planners and practitioners. Although their research places the role of management in
the forefront of development policymaking, corrective actions are by no means easy to implement.

Rigid employee compensation and promotion systems typically encountered in SOEs serve to weaken links between incentives and performance. Another consequence of inherited personnel apparatus is the resultant lack of managerial control over employee behavior. Frustration of government department managers over the inability to hire and fire is by now legendary and carries over to public enterprises unless greater flexibility is built-in. Then too, managers themselves are held to low standards of performance and accountability: “Avoid losses” is hardly an exhortation to excellence. The problem is exacerbated if internal management information and reporting systems are deficient or non-existent.

A re-examination of the justifications for the establishment of SOEs reveals sets of conflicting objectives. Promoting regional development, subsidizing necessities, and providing employment can likely be achieved only at some sacrifice of financial viability. Where state enterprises are expected to pursue both commercial and social goals and answer to many different constituencies, their performance will suffer unless they are given a clear sense of priorities. Without that, losses are too easily blamed on social goals, and bad management is thereby camouflaged. The trick is to achieve control without outside interference. This is best achieved by clearly setting out a set of objectives and granting management sufficient autonomy to achieve them free of day-to-day political meddling.¹⁹

Relative Efficiency of Public vs. Private Enterprise
A major theme in the debate over the relative efficiency of public vs. private enterprise is the notion that public ownership is inherently less efficient than private ownership. Conservative economists are the leading proponents of this view. The essential argument is based on the fact that public ownership is diffused among all members of society, and no member has the right to sell his or her share. Given these aspects of public ownership, there is little economic incentive for any one owner to monitor the behavior of the firm’s management. In contrast, the ownership of private firms is concentrated among fewer individuals, each having the right to sell his or her share. With a personal
stake in the matter, the owners are thus motivated to scrutinize management to ensure efficiency in the production of goods and services.

A parallel view identified with liberal economists holds that efficiency is predictable on the basis of market structure. The key element is the presence of effective competition among firms. In the competitive market, efficiency becomes a precondition for survival—at least for privately owned firms.

The two classifications of ownership, public and private, and the two classifications of market structure, competitive and non-competitive, define four categories:

**TABLE 2. Modes of ownership and market structure**

<table>
<thead>
<tr>
<th>MARKET STRUCTURE</th>
<th>OWNERSHIP</th>
<th>COMPETITIVE</th>
<th>NON COMPETITIVE</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Private</td>
<td>I</td>
<td>III</td>
</tr>
<tr>
<td>COMPETITIVE</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>PUBLIC</td>
<td>I</td>
<td>II</td>
<td>IV</td>
</tr>
<tr>
<td>NON COMPETITIVE</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
An important question of public policy is how the four categories of firms rank in terms of relative efficiency. There is little doubt that expert opinion would rank quadrant I enterprises as the most efficient and quadrant IV organizations as the least efficient. Ranking the remaining two categories would be more difficult. Most empirical studies have involved quadrant III/quadrant IV comparisons, in that the private firm operated as a regulated utility monopolist or a domestic airline insulated from competition by regulation. The utility study seems more to be an exercise in the efficiency of regulation and monopolists’ response to it and was otherwise inconclusive. The airline study compared the performance of Australia’s domestic carriers, TAA (state owned) and Ansett (private), during the period 1958-68. To satisfy political elements of the left and right, Australia’s two-airline policy equalized routing, aircraft type, capacity, costs, and tariffs. The similarities between the public and private airlines even extended to time schedules, with the TAA and Ansett planes taking off and landing almost simultaneously. The situation became so intolerable in 1964 that the government became concerned over the possibility of collision. After the Commonwealth applied moral suasion, the airlines agreed to stagger the flights by a few minutes! Given this degree of regulation, one might expect the performance of the two carriers to be equal. However, three productivity measures averaged 13, 22, and 104 percent higher for Ansett, clearly suggesting that the private company is more efficient than the public enterprise.

How would the findings differ if the private and public firms coexisted in a competitive environment? One 1980 study compared the Canadian National (CN) and Canadian Pacific (CP) Railroads. They are large railroads of roughly equal size. The CP is a privately owned railroad, while the CN is a Crown corporation, wholly owned by the Canadian government. The CN became a nationwide competitor of the CP in 1923, when the government took over and consolidated the operations of several failing railroads. Since World War II the CN and CP have additionally faced stiff competition from other modes of transportation.

Contrary to what might be predicted on the basis of ownership, the study found no evidence of inferior performance by the government-owned railroad. In fact, the CN achieved larger gains
in productivity than the CP since 1956. The conclusion in the case of Canadian railroads is that the beneficial effects of competition have been sufficient to overcome any tendency toward inefficiency resulting from public ownership.22

Important lessons for privatization policymakers flow from these research results. If it is accepted that competition has a greater impact on efficiency than does ownership, then there is little to recommend a policy that replaces monopolist state enterprises with monopolist private firms. On the other hand, if a sole government producer is replaced by an actively competitive environment, a bigger pie results. And an enlightened state, so the theory goes, can use its powers of taxation and transfer to achieve an equitable distribution. As William Safire satirized in his "Ode to Greed":

Greed is finally being recognized as a virtue. Dressed in euphemism—"the profit motive" or "growth incentives" or "the entrepreneurial spirit"—our not-so-deadly sin turns out to be the best engine of betterment known to man.
The world has learned that to concentrate on divvying-up diminishes us all, while scrambling to help ourselves helps others; without Greed, there is no wherewithal for Generosity.23
BENEFITS AND COSTS OF PRIVATIZATION

By now it should be apparent that privatization decisions are complex and not clear-cut. It is helpful to structure the problem as a benefit-cost analysis. In principle, the government can list the benefits and costs of each proposed privatization action, quantifying the anticipated impacts insofar as possible. Unless the benefits considerably outweigh the costs, the political costs of change will hardly be worth incurring.24

Interest Groups

A difficulty that arises in performing the benefit-cost evaluation is how to deal with the contending interests of various groups within society. Space considerations and lack of expertise in political class analysis preclude an adequate treatment here. However, the list of interest groups would certainly include:

- Politicians
- SOE board members
- Public sector managers
- Public sector employees
- Capitalists/entrepreneurs
- Public as taxpayers
- Public as consumers

Reactions of some groups are fairly predictable based on self-interest. Board members of SOEs stand to suffer a loss of prestige and tend to favor the non-privatized status quo. Public employees, especially if unionized, have been among the strongest opponents of privatization for reasons of job security and loss of “tenured” positions. These concerns have been alleviated in successful privatization initiatives through continuity of employment agreements, contractor preference requirements, phase-in plans, compensatory payments, and worker ownership/profit-sharing schemes.
Regardless of the micropolitics employed for protecting various interests, some trade-offs are inevitable. The benefit-cost calculus requires that prioritization or weighting factors be applied and decisions made accordingly. On economic efficiency grounds, highest priority should be accorded to effects on consumers. Effects on taxpayers must also be considered but should not overwhelm the interests of the consuming public. Unfortunately, in the struggle to contain deficits, governments contemplating denationalization have displayed a disproportionate concern for revenue raising in the privatization process. Although the sale value of a state asset is not unimportant, it should not influence the decision to privatize. The value of an SOE could clearly be artificially increased by granting a monopoly or announcing restrictions on competing firms' entry, but this would be counterproductive to consumers. Similarly, the prospective poor proceeds from a sale should not in themselves deter denationalization. A rough analogy can be made to the decision to sell a pig. Most owners decide to take a hog to market when they need the money or when the pig is particularly fat. Scientifically speaking, however, the pig should be sold when its productivity—growth rate—is no longer satisfactory. This fact should not deter the owner from fattening the pig before the sale. In the year or two before denationalization, it generally pays a government to "spruce up" a state enterprise by instituting management reforms, thus increasing its attractiveness to potential buyers.

**Benefits**

Benefits to be derived from privatization have been implied throughout this exposition but bear explicit restatement:

- May enhance efficiency and lower costs of government services. A study of contracting-out in U.S. cities and counties by the Urban Institute reported average gains of between 20 and 25 percent. Apparently, the gain in efficiency outweighs the added cost represented by private profit.

- May permit greater flexibility in tailoring program size or coverage. In large countries, the government is compelled to establish units of production that may exceed the opti-
Privatization Possibilities

mum scale. A combination of smaller private suppliers might better exploit economies of scale.

• May relieve government management load and service delivery burden. Management talent is one of the short supply resources of the public sector.

• May shrink government deficits and release resources for more productive application by reducing waste. Privatization imposes business practices, such as full-cost pricing, that governments may lack the political willpower to institute.

Costs

Costs of privatization are similarly presented in summary format:

• May result in loss of control. This is of particular concern to governments engaging foreign contractors or buyers.

• May impose an excessive administrative and monitoring burden. The dollar cost of regulation and enforcement is rarely explicitly identified.

• May result in a lower level or quality of service. Because of the profit motive, for-profit firms may practice cost reduction at the expense of service quality. At the extreme, private firefighters in Arkansas decided to let a house burn because the owner had failed to pay his fire protection dues.

• May result in adverse distributional effects. This is especially true where a private firm takes over a heavily subsidized state service, such as a utility, without provision for continuing direct subsidy from government. Rural electrification investments, for example, may be bypassed by the private utility. The alternative, cross-subsidization, is highly subject to political maneuvering.

• May result in service disruption due to business failure. Many leasing and service contracts contain a “repossession” clause that allows a government to resume direct control in the event of bankruptcy. However, the difficulties of reorganizing government services on short notice may be formidable.

• May result in employee dislocation. While the effect is temporary, the stresses are nonetheless not very palatable.
• May invite corruption. Lack of clear-cut, open bidding procedures and written, objective contractor selection criteria creates opportunities for kickbacks and bribery.
TOWARD A BASIS FOR COMPREHENSIVE DECISION MAKING AND IMPLEMENTATION

While privatization decisions must be approached on a case-by-case basis, governments should institute some sort of comprehensive review and implementation system covering the range of government functions. This is the privatization program.

Steps in the Privatization Program
Phases in a privatization program even for isolated island economies are measured in months and years, not weeks. One possible series of steps in a national effort is outlined below.

1. Institutional development—This paper is but a small example of the organizational and educational preparations that must precede potential or actual privatization transfers. Key actors must be identified and the political situation assessed. Guidelines for those coordinating the privatization effort are outlined. Private sector coalitions are formed, and a two-way dialogue with government policymakers is fostered.

2. Strategic choices—At this stage, the goals and objectives of the privatization program are set and present policies reviewed. Also determined is the government's stance on liberalization of its management of the economy. Evaluation and decision criteria are adopted and may take the form of matrices, checklists, or ranking factors.

3. Selection of the candidates—Here attention focuses on specific sectors and industries. Present government services are surveyed and their effectiveness is scrutinized. Business conditions, including the probable extent of competition in the target industries, are investigated. If a decision to privatize is reached, appropriate modes of finance and production must be chosen.

4. Securing of legislative consent—Most public enterprises are covered by enabling legislation that defines the legal basis for operation. Unless the law gives a cabinet minister the express authority to assign statutory functions to the private sector, considerable parliamentary time will be required. A similar
warning applies to economic liberalization (e.g., tax and duty) measures.

5. Preparation for transfer—The valuation of the asset or right to be transferred is estimated, often with the aid of expert outside appraisal. Terms of the offer and bid procedures are drawn up, as well as acceptance criteria.

6. Privatization transfer—Bids are evaluated, and a successful bidder is selected. In the case of a stock sale, the new issue is floated. Subsequent to negotiation, the actual mechanics of transfer are executed.

7. Monitoring of the results—The process is not complete until regulatory and oversight mechanisms are established. Then begins the task of performance monitoring to ensure that government has not abandoned its responsibilities to the public.

The focus of this paper has been on the first three steps of the privatization program. The associated aspects of implementation will perhaps be the subject of future research and discussion, and detailed models exist both within and without the region. Before specific references are made to the Pacific islands, some additional comments are offered on the decision-making process.

Setting Objectives
Before embarking on privatization, the government must have a clear idea as to what its objectives are for the program and why it is undertaking it. Governments may not always find it politically desirable to enunciate these publicly and in detail as any one of them may well alienate some faction in their constituency. But it is essential that within the inner circles of government the goals be understood. In particular, the relative priority attached to each objective ought to be settled because occasions will occur when they point in quite different directions.27

The “administratively rational” approach to making strategic choices is to establish an official inquiry of some form (i.e., committee of inquiry) to weigh the options and make recommendations. Committee work has a reputation for slowness, and the high visibility of “blue ribbon” panels may even foster the mobilization of opposition. Nevertheless, such a procedure drawing upon a reasonably balanced group of “outsiders” can play an im-
important role in information gathering and consensus building. The suggested composition includes policy-level officials well placed within the political hierarchy, government financiers, bankers, businesspeople, consumer representatives, development planners, and persons with technical expertise in law and contracts. In addition, adequate budgetary resources must be allocated for a support staff drawn from government administration backgrounds.

Choosing a Mode of Privatization
In general, the specific mode of privatization will be suggested by the type of good or service in question. We have already seen that some goods and services, such as national defense or street lighting, cannot be denied to one individual without denying them to all and so must be supplied collectively. These "public goods" could be produced by the private sector but must be financed by the public sector. At the other extreme, private goods such as food and clothing are suitable for provision by the private market in a direct exchange of goods and income.

In between are "toll goods" and "common pool goods." Although the purpose of this paper is not to elaborate on the details, access to toll goods can be denied for non-payment, but their supply requires some collective action. Water and electric power are examples requiring cooperative action for pipes and running lines. Common pool goods and services are those whose continued supply will not be assured through the market as private parties will tend to squander them. For example, if oil exploration rights were not parceled out, every strike would produce a rush of drillers, each endeavoring to pump out the oil field as fast as possible.

Links between types of goods and common methods of privatization suited to each are summarized in Table 3. Choice of privatization mode within categories may be made on political feasibility considerations.
<table>
<thead>
<tr>
<th>Type of good</th>
<th>Common modes of privatization</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private</td>
<td>Voucher</td>
<td>Food</td>
</tr>
<tr>
<td></td>
<td>Voluntary service</td>
<td>Clothing</td>
</tr>
<tr>
<td></td>
<td>Divestiture</td>
<td>Housing</td>
</tr>
<tr>
<td></td>
<td>Load-shedding</td>
<td></td>
</tr>
<tr>
<td>Toll</td>
<td>Franchise</td>
<td>Electricity</td>
</tr>
<tr>
<td></td>
<td>Management contract</td>
<td>Telephone</td>
</tr>
<tr>
<td></td>
<td>Joint venture</td>
<td>Water supply</td>
</tr>
<tr>
<td></td>
<td>Lease-out</td>
<td></td>
</tr>
<tr>
<td></td>
<td>User fees</td>
<td></td>
</tr>
<tr>
<td>Common pool</td>
<td>Franchise</td>
<td>Oil and gas</td>
</tr>
<tr>
<td></td>
<td>Contract</td>
<td>Minerals</td>
</tr>
<tr>
<td></td>
<td>Joint venture</td>
<td>Groundwater</td>
</tr>
<tr>
<td>Collective</td>
<td>Contract</td>
<td>Road maintenance</td>
</tr>
<tr>
<td>(Public)</td>
<td>Voluntary service</td>
<td>Agriculture pest control</td>
</tr>
<tr>
<td></td>
<td>Voucher</td>
<td>Social services</td>
</tr>
</tbody>
</table>
PRESENT STATUS AND FUTURE POSSIBILITIES FOR PRIVATIZATION IN THE PACIFIC

As an American territory, American Samoa has received a major subsidy from the U.S. government. The ability of the U.S. government to maintain transfer payment levels under Gramm-Rudman pressures is doubtful and provides a strong motivation for cost-of-government reduction. As a relative forerunner in the privatization process, American Samoa serves as a barometer in the Pacific.

American Samoa Experience
Prior to 1984, the American Samoa government ASG had limited experience in providing services through the business sector. In the 1960s and '70s, the ASG-owned Rainmaker Hotel was operated by management contracts with U.S. firms. More recently, Pacific Resources Incorporated was awarded a long-term lease to operate the ASG-owned fuel storage and distribution system. However, the most common experience over the last several years has been for the ASG to hire contract employees to manage government activities such as the American Samoa Power Authority.

In January 1984 the ASG announced its intention to break away from an ad hoc approach to contracting government services and to begin to develop a privatization program. At that time, the governor established a Blue Ribbon Commission on Privatization. The commission was composed of eleven members, six of whom were business and political leaders from American Samoa and five of whom were business and federal government representatives from the U.S. mainland. The commission was granted a one-year charter and met three times between June 1984 and January 1985. During this time the commission identified and ranked more than 20 targets of opportunity for privatization and initiated two privatization actions. The first was for the lease of an ASG-owned milk, juice, and ice cream processing plant and distribution system with a concurrent one-year contract for
the production, supply, and delivery of milk and orange juice for the ASG school breakfast and lunch program. Based on an independent evaluation of the contractor’s performance, ASG officials determined that the contractor met the conditions and terms of the lease and contract and thereby qualified for an extension of the contract and the negotiated sale of the ASG facility and equipment.

The second privatization action involved the 130-person ASG Marine Railway and Ship Repair Facility. For several years the facility had averaged losses of about US$400,000 annually, despite a significant investment of federal funds to modernize the physical plant. The ASG issued a request for proposals to lease and operate the ship repair facility and sent it to eight U.S. firms. Two companies submitted proposals. Southwest Marine Inc. was awarded the lease in January 1985 and began operations soon thereafter. The company has taken the railway on a 15-year lease with the option of renewal for another 15 years at an annual rent of $100,000 or 2.5 percent of the gross annual receipts, whichever is higher.

The ASG has since embarked on several other privatization initiatives including sale of the Rainmaker Hotel; franchising liquor sales; contracting for ASG motor vehicle fleet requirements; undertaking public works heavy equipment functions; collecting and disposing of garbage; and providing ambulance, custodial, and food services for the ASG hospital. To date three liquor sales licenses have been granted, and six bids for the collection of garbage have been received.

The political commitment of Governor Afioga Lutali’s administration to privatization is strong, and the approach is systematic and well organized. Detailed policies and procedures are contained in the ASG Privatization Handbook. It is perhaps too early to evaluate the benefits accruing to consumers; impacts on government expenditure have, however, been favorable.

Privatization in Other Pacific Island Countries
While budgetary circumstances in the American entities impose strong incentives for privatization, interest runs high around the Pacific. The following are some privatization highlights culled from Pacific press sources.
In Pohnpei, Federated States of Micronesia, Governor Resio Moses reported that the state “has almost entirely withdrawn from direct competition practices against the private businesses.” Citing that government vehicle repair services, sand and coral dredging operations, and the MV Kacho barge have been successfully transferred to the private sector, Moses said that under immediate consideration for privatization are the rock quarrying operations and the water, power, and sewer utilities. Additional candidates are government cafeterias, operation of interisland fieldtrip ships, school busing, the cold storage plant, and the public works electrical, plumbing, and carpentry shops.

In Fiji, the Asian Development Bank is providing advisory technical assistance for privatization of the government shipping fleet and commercialization of the government shipyard in Suva. The technical assistance will help the government in implementing its decision to withdraw non-essential government vessels from commercial shipping, sell them to the private sector, and take other measures to further rationalize services for interisland shipping. It will also help the government enter into a joint venture with private business to run the government shipyard on a commercial basis. The moves follow the earlier contract award to Qantas for the management of Air Pacific and the contract to Australia's Channel Nine for television broadcasting service beginning by or before 1987.

In Vanuatu, the government is seeking to negotiate for more favorable electricity charges with the franchisee, UNELCO. The government hopes to obtain outside expert advice on power generation and related manpower costs and to use the information as a basis for fixing electricity tariff rates. UNELCO has been the sole generation authority on Efate since 1937. Other privatization issues in Vanuatu are being examined with the aid of the Asian Development Bank.

In French Polynesia, one of the success stories of the local economic scene is the hydro-electricity producer Marama Nui. After only a few years of operation, Marama Nui generated 9 percent of total Tahiti electricity production in 1983. By 1992, after planned expansions, some of which are already underway, the company plans to be producing 50 percent of the power needs of the territory. A feature of Marama Nui's company structure—
and one that local observers see as a key to its success—is that many of its employees, including a number of relatively low-paid workers who toil in the mud and slush of the dam construction sites, are shareholders in the enterprise. It is also the only private company in the territory in which the local government holds an interest.

In Solomon Islands, the government is considering selling off some shares in the 100 percent state-owned Hotel Mendana and is simultaneously seeking overseas joint venture partners. The hotel has been managed under contract by an English firm. In another privatization development, government houses have been sold to their civil servant occupants. However, the allocation procedures governing the sale have come under criticism on grounds of political favoritism.

And in Niue, public service will gradually have its size cut by the encouragement of private enterprise to take over some activities now performed by the government. Some of the jobs done by the public works department and certain ventures run by the agriculture department are considered suitable for transfer to private hands. A key factor in the stimulation of Niue's small private business community will be the island's development finance fund.

**Future Privatization Possibilities in the Pacific**
The collective experience of the islands suggests a laundry list of possibilities:

1. Electricity
2. Water supply and sewerage
3. Agricultural marketing boards
4. Agricultural services
5. Agro-industry (agricultural estates)
6. Interisland shipping
7. Ferry service
8. Air transportation
9. Telecommunications
10. Broadcasting
11. Financial services
12. Housing
13. Maintenance and repair services
Privatization Possibilities

14. Hotels
15. Bond stores
16. Food service
17. Refuse collection
18. Printing

Special Considerations Relevant to the Pacific

The size and isolation of Pacific island economies present serious constraints to the degree and type of privatization actions that may be attempted. First and most obvious is the private sector's small size, both in relative and absolute terms, in many island countries. Effective competition, usually defined as at least three or four potential market entrants, is thus stifled. Fledgling or non-existent capital markets make it difficult to raise investment capital from domestic sources. Only Papua New Guinea is seriously considering a national stock exchange, and government approval is expected in the near future. The alternative for most island nations—foreign participation—must take into account fears of foreign domination. Privatization in the Pacific in the capital-intensive sectors will thus take the forms of partial divestment, 51 or 49 percent joint ventures with foreign partners, and lease-out, contract, and franchise arrangements, wherein the government retains ownership of fixed capital and infrastructure. Full divestiture, à la Britain and France, is thus unlikely in the Pacific.

In parallel with concerns of expatriate domination of the economy are the realities of concentration of domestic private capital and entrepreneurial expertise. These aggregations may reflect ethnic (e.g., Fijian Indians) or geographic (urban elites) divisions. For example, from the author's experience in Western Samoa it is estimated that no more than 15 principally 'afa kasi families have access to sufficient capital and business know-how to participate as bidders in large-scale privatization actions. Even with the assumption of adequate competition, the resulting income distribution may run counter to broad government aims. To the extent that island taxation and transfer systems are effective, these inequalities can be rectified. From observation, however, it must be admitted that many island fiscal systems lack sophistication and are primarily designed to raise revenues rather than to be instruments of social engineering.
Role of the Pacific Business Community
The most important role that the islands' private sector can play is to show interest in potential privatizations and put forward bids. Governments need to be convinced that a reasonable level of private sector interest exists in the operations being privatized before they are prepared to start the privatization process. The fear of an embarrassing failure is a major barrier to government privatization action. Nothing is more dampening to private sector enthusiasm than to invest many hours in preparing a responsive proposal, only to have government suddenly change its mind on privatizing. One island state has already flip-flopped on its decision to privatize utility services.

Such misunderstandings can be reduced through the establishment of a private sector-public sector dialogue. Private companies and island chambers of commerce could conduct reviews of the public sector and suggest which functions could be transferred to private hands and which interests would like to undertake them. These discussions might help bridge the wide gaps that presently exist between governments and businesses in the Pacific.
CONCLUSION

The privatization path is long and twisting, and island governments must avoid the temptation to rush the journey. Although economic forces may prompt it, privatization is fundamentally a political decision. Measures of efficiency and equity are the sometimes conflicting economic yardsticks of the gains and losses from privatization. Governments will find it easier to reconcile these conflicts if they are clear from the outset as to what their privatization objectives are. In addition, privatization plans will be easier to digest if they contain multiple options for political decision makers. The Pacific business community can assist in defining the feasible range of options.

Indiscriminate selling off of state assets to meet government current account liabilities is a tempting but ultimately damaging privatization strategy. In fact, full divestiture is unlikely to be widely adopted in the Pacific, for reasons of loss of control and concentration of wealth. Other options exist, but economic liberalization and the promotion of competition should be components of any privatization strategy.

Above all, privatization decisions must be considered on a case-by-case basis. Exhortations of the ideological right, and naysaying of the ideological left, have little place in the pragmatic, consensus-seeking Pacific.
APPENDIX

GOVERNMENT OF PAPUA NEW GUINEA - COMMERCIAL INVESTMENTS

Post & Telecommunications Corporation
National Broadcasting Commission
Air Niugini
PNG Shipping Corporation
Pacific Forum Line
PNG Harbours Board
PNG Electricity Commission
Energy Development Corporation
National Housing Commission
PNG Banking Corporation
PNG Development Bank
Investment Corporation of PNG
Niugini Insurance Corporation
Food Marketing Corporation
New Britain Palm Oil Development Co. Ltd.
Hargy Oil Palms Pty. Ltd.
Higaturu Oil Palms Pty. Ltd.
Higaturu Processing Pty. Ltd.
Higaturu Transport Co. Pty. Ltd.
Ramu Sugar Holdings Pty. Ltd.
Kagamuga Natural Products Pty. Ltd.
Baiyer River Ethanol Ltd.
Cape Rodney Nursery Development Corporation
National Plantation Management Agency
Copra Marketing Board
PNG Forest Products Ltd.
Stettin Bay Lumber Co. Pty. Ltd.
Open Bay Timber Co. Pty. Ltd.
Gogol Reforestation Co. Pty. Ltd.
Celcure Pty. Ltd.
PNG Fish Marketing Corporation
Bougainville Copper Ltd.
Ok Tedi Mining Co. Pty. Ltd.
Sea Park Pty. Ltd.
Davara House Pty. Ltd.
Disciplined Forces Canteen Organisation
19 Provincial Government Development Corporations
Local Government: e.g., KKB Limited

*Investment Corporation of PNG -
Majority Held or Controlled Companies*
ANG Group
Angco Group
Ilimo Farm Products Pty. Ltd.
Jimi River Cattle Company
Kigibah Plantation Pty. Ltd.
Kilip Goi Project
Kolum Opints Project
Radio Taxis Pty. Ltd.
Wewak Timbers Pty. Ltd.

*PNG Development Bank - Majority Held or Controlled Companies*
Niugini Table Birds Pty. Ltd.
Nationalwide Rent-A-Car
Hebamo Press
Gerehu Supermarket
Sugu Bulmakau
Hi-Lift Co.
Hohola Softdrinks
Wirus Bulmakau
Koita Oro Boroma
Mamba Development
Street Pasin Stoas (40 Stoas)
Boolaroo Signs
Yareba Bulmakau
Zifasing Bulmakau
Yakuasa Bulmakau

*Source:* Trebilcock, Michael J., "The Government as Entrepreneur - Public Enterprises in Papua New Guinea."
NOTES

4. Ibid.
8. Ibid.
10. Ibid., pp. 59-61.
12. Ibid., p. 56.
17. Trebilcock, op. cit., p. 4.
19. Ibid., p. 76.
25. Ibid.
31. Ibid.
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THE PACIFIC ISLANDS DEVELOPMENT PROGRAM (PIDP) at the East-West Center helps meet the special development needs of the Pacific islands through cooperative research, education, and training. Its quality in-depth research provides island leaders with information on alternative strategies to reach development goals and meet the needs of the island peoples.

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At its Tenth Meeting in January 1986, the Standing Committee endorsed a set of new projects for PIDP. These are health and nutrition, roles of multinational corporations—petroleum marketing and supply, Pacific youth, policy analysis, role of the private sector in Pacific development, and urban and rural life.

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