Good Governance and the Privatising State: Some International Lessons

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Good Governance and the Privatising State: Some International Lessons
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(One Cheer for Victoria’s Privatisations, Now What Have We Learned?)

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Abstract

We have been privatising around the world with fanfare now for close to three decades. What have been the lessons, and in particular, what have been the lessons for Victoria from the perspective of good governance? This paper reviews the international lessons of privatisation and discusses which of these relate to good governance. The conclusion of this paper is that most of the lessons learned from our global experience of privatisation are relevant to Victoria, and that nearly all of these involve the principles of good governance. The actual effects of privatisation on good governance are surprisingly mixed, however. If governments are to govern better than they have to date in the midst of privatisation, then they will need to heed each of these lessons and more cautiously consider reform options than the largely ideological responses observed to date.

Introduction

Following the rush of British privatisations in the 1970s and 1980s, as well as those in New Zealand and elsewhere, Australia was keen on privatisation through the 1990s. The state of Victoria, saw $33billion in sell-offs, and led the world during that decade on the basis of sales proceeds as a proportion of GNP. This state also saw $11billion of services redirected to private contractors for the next two decades; (Russell, Waterman & Seddon 2000). But what has 20 years of privatisation around the world taught us, and how do the implications of such lessons compare with our experience in Victoria’s privatisation experiment?
Interestingly, there is much to be learned from the international experience if we are prepared to throw away the political rhetoric, the economic dogma and the quick one liner and learn from the empirical evidence.

**Eight Lessons of Global Privatisation Experience**

The first lesson is that, looking at the empirical evidence, privatisation has nearly always seen strong winners and losers around the globe. The World Bank’s own 1996 report, for instance, found investors winning in nearly every case of the dozen analysed whilst citizens either gained nothing or lost in two thirds of cases (Galal et al. 1994). Other cases around the globe have seen similarly mixed results. When analysis of the sale of Argentina’s telecommunications company ENTEL suggests that the country as a whole was worse off by around $2.2billion whilst international investors gained over $6billion, citizens become sceptical of the economists calculation of an overall world-wide ‘welfare gain’ (Abdala 1992). They ask, as have many regional voters in Australia more recently, ‘whose economy is privatisation good for?’ In a similar vein, international evidence from the UK and US suggests that women and minority groups have usually borne the brunt of efficiencies gained through contracting-out government services (Hodge 2000).

The second lesson is that philosophically, we know that any hardened ideology, whether rampant deregulatory marketism at one end or collectivist socialism at the other, is equally dangerous. Reformers become pathologically blind and lose touch with reality. Sure, the demise of centrally planned economies showed that the mixed economy was a powerful engine for economic growth. But it also showed that privatisation without good governance leads to a corrupt state. Russia’s ruthless and swift privatisation program, for instance, has now seen some 70 percent - 80 percent of all former USSR government organisations reputedly being ‘obliged to make payments to criminal gangs, corrupt officials or racketeers’ (Prokopenko 1998). Strong communities, and strong mixed economies need both a strong government and a strong private sector, by definition.

Thirdly, privatisation was as much about power and influence, as about economics. Whether it was Margaret Thatcher’s Britain or Jeff Kennett’s Victoria, it was a power, and hence a political, game. Despite the bluster, there were no equations or calculations proving which parts of government ought to

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be privately or publicly owned. It was all contestable. Perhaps the redistribution of power was beneficial, but maybe we risked simply trading union domination of government for domination by businesses and banks? Maybe we also traded the lure of possible future benefits for large actual cash flows paid immediately to chosen advisers and merchant bankers.

Fourthly, the relative overall economic gains from privatisations around the world have been found to be surprisingly modest, aside from the obvious once-off cash flow bonanza. Sure we increased the confidence of private businesses and the money markets, but the much touted productivity and financial performance gains have been more difficult to find. Hodge (2000) reported some 10,468 ‘before’ and ‘after’ performance measurements from enterprise sales around the world. There was little evidence of significant productivity or efficiency gains. It also found that when gains for consumers had been measured, these had been due more to strong regulation and open disclosure of performance information rather than ownership change. In fact, analysis for the case of British Telecom showed that these factors were three times and eleven times more powerful, respectively, than changing ownership (Hodge 2000).

Fifthly, one of the major casualties in the international privatisation game appears unfortunately to have been accountability. Top-down accountability of corporations to meet their managerial goals may have increased, but this appears to have been at the expense of public accountability, which has been more mixed. Indeed, the recent Audit Review of Government Contracts in Victoria, concluded that there had been unnecessary secrecy surrounding the

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2 Walker and Walker (2000, p. 250) indicate that these fees have been as high as 6.8 percent of the sale proceeds in the case of British Telecom, but have more usually been around one third of this value. Nonetheless, the size of such fees has usually been notoriously difficult for citizens to ascertain.

3 We might surmise a host of reasons for this surprising result. We could postulate firstly that earlier privatisations represented those which were simpler and less sophisticated, paying less attention to strengthened regulation, price controls and competition. Secondly, we might question the use of particular research techniques such as meta-analysis. Against this, though, parallel comprehensive investigations of the UK privatisations using other techniques in the late 1990s also found ‘little evidence of any systematic improvement in performance’, with performance having improved in 82 instances (51.6 percent) and having deteriorated in 77 instances (48.4 percent) according to Martin and Parker (1997, p. 215). Thirdly, we might believe that the relationship between private ownership and improved performance does exist, but that, it is more complex than first assumed and likely to take perhaps decades before the data eventually yields sufficiently strong proof. Lastly, we might surmise that there is indeed little inherent difference between the efficiency of the public and private sectors.
sale of assets and major contracts entered into by the state and suggested more open and transparent government. Put more simply, the overuse of commercial-in-confidence during the Kennett era was a breakdown in Westminster democracy as we knew it. Such was the secrecy culture during this regime, that central government departments even refused to show Parliamentary Committees their own corporate plan under this guise! Lessons we should have learned through the heady entrepreneurial disasters of the 1980s were all forgotten, somehow.  

Of course, the idea of using both public and private resources to deliver government services had been around for at least 150 years in many western countries – and so had the debate. The 23,914 global ‘before’ and ‘after’ performance measurements on contracting-out government services summarised in Hodge’s (2000) research showed, for instance, that it had worked well in some areas and not in others. But the promotion of private delivery as the answer to all public policy ills - as the single, one size fits all panacea – was a new twist. It is now being judged as one which, in retrospect, was too simplistic by half. In a word, it was misleading. This was the sixth lesson.

Of course we do gain some things from competition, from reviewing service delivery methods and from better specification of services. But our experience is also teaching us that there are big gaps between the privatisation and market rhetoric and the new realities. A key lesson here has been that when government ideology takes over from sensible organisation and business operations, government itself becomes dumbed down and hollowed out. In Melbourne, the State Auditor General undertook a performance audit of outsourcing and found the Victorian Department of Treasury and Finance having to telephone its contractor to get them to document the objectives of the Kennett Government’s wholesale outsourcing strategy! Here, government had clearly been ‘hollowed out’. Today, more than ever, we need stronger, more creative and more capable government, not simply a contract

4 A consistent learning through the international research on contracting-out is the possibility of undue business influence in political decision making, and the rise to prominence of issues such as ‘conflict-of-interest’ and ‘commercial-in-confidence’. We might note that the phrase commercial-in-confidence was used by both the private Westpac bank organisation to suppress its $33m loss from customers, and the Western Australian state government itself when it quietly bankrolled the failed Rothwells Bank recovery attempt and Bond Corp’s doomed Kwinana project. Of course it is not one political leaning or other which is at issue here. Nor is it the private or public sector that is at issue. It is the need to be continually vigilant to balance our personal and political behaviour with our desire for better organisational productivity and growth.
administrator. With globalisation already at our doorstep, we ought to have already learned this lesson over the past few centuries. But we didn’t. It is now lesson seven.

Perhaps the ultimate lesson from experience, number eight, came from the electricity shortages in Victoria early in 2000. Kennett’s sophisticated electricity market was regarded as highly efficient, with almost magical properties. Yet, as power restrictions were enforced onto citizens in Victoria, power was being sold to New South Wales. No - markets do not naturally serve the public interest! They themselves require good governance if they are to work for us. Governments of the future neglect this eighth lesson at their peril.

So what can we conclude, looking over all eight lessons? Perhaps the one overarching theme for governments around the globe is apparently to ‘be careful’. But to what extent do all of these international lessons also apply to Victoria’s experience over the past decade? I would argue that to a large degree, similar lessons have been learned, despite the relatively sophisticated approach taken to later sectors such as electricity and transport. Before we look at the detailed explanation of this, let us return to our theme of good governance.

**Good Governance**

There are many ways in which the term ‘governance’ is used. Kooiman (1999) for instance, outlines ten. I intend to expressly reject adopting the notion of corporate governance (ie, the way big organisations are directed and controlled), the notion of governance as some sort of minimalist state which ‘steers not rows’ in Osborne and Gaebler’s parlance, or the notion that good governance is somehow related to a powerful government which unifies and controls all institutions in order to avoid any appearance of divided, pluralist, and richer liberal democratic debate. Instead, I will adopt Kooiman’s (1999) definition of ‘social-political’ governance as

> all those arrangements in which public as well as private actors participate aimed at solving societal problems, or creating societal opportunities, and attending to the institutions within which these governing activities take place.

This definition therefore encompasses a wide array of mechanisms ranging from the Parliamentary, through the representative, quasi-judicial and
independent, to those more local or community based. Searching for a more straightforward definition of ‘good governance’ we might view it as simply

a system that is transparent, accountable, just, fair, democratic, participatory and responsive to people’s needs (Commonwealth Innovations 1999).

Other elements of good governance have also been codified, such as has been achieved by Hunt, Kiss and Murrell (1999) for local government. Central to their ideas are the areas of community, representative democracy, participative democracy and corporate governance in conjunction with the governing body – the local council.

Whatever definition of good governance is adopted, it is apparent that almost every one of the eight lessons from our global experience of privatisation are relevant to the notion of governing well.

So, with the knowledge of global privatisation lessons, and a better sense of the meaning of governance, how then might we judge the results of Victoria’s privatisation experiment? Let us return to the earlier theme of the international lessons from privatisation experience and contrast these to the results of Victoria’s privatisation experiment.

Assessing Victoria’s Privatisation Experiment in Respect to Good Governance

Looking at Victoria’s privatisation experience from the perspective of the eight international lessons, what can be concluded? This paper argues that Victoria’s results, like those from the world experience, have been quite mixed, and often not up to expectations. Moreover, many of these expectations for outcomes to be delivered have incorporated substantial elements of good governance. On what grounds can we make this conclusion? Let us both comment on Victoria’s privatisation outcomes as well assessing the degree to which good governance has been a central feature.

Firstly, if Victoria’s experience was consistent with the international lessons, we would continue to see the theme of ‘winners and losers’. To what extent has this occurred? Only partly. Our asset sales, particularly those later in the program, were generally more sophisticated, having learned the preference to utilise trade sales to maximise proceeds so that Victorian citizens were not
open to the same level of losses as elsewhere\(^5\). Important also in minimising potential losses to consumers, in sectors such as electricity, was the strong control of domestic price regimes instituted throughout the state to that of the increased price level set just prior to the initial privatisations and the strengthened overall role of the Office of the Regulator General. Where prices were put to the new markets, such as occurred with the direct purchase of power by industry, average price reductions of 10 percent were reported (Dept Treasury and Finance 1997). Here, the Vitorian Government appears to have done better than much of the earlier international experience. In terms also of electricity supply quality, a decline in the total length of time customers spent ‘off-supply’ has been reported, though with an increased frequency and total time spent off supply from unplanned interruptions (ORG 1999)\(^6\).

But many of the same winners seemed to turn up at the privatisation party, too. Merchant bankers, investment brokers and management consulting companies saw a bonanza and were winners. City based tender winners, senior executives with higher public sector salary packages to administrate more complex contracts, and mates of Ministers all did well, if we believe the press surrounding the Casino tendering scandal and the Intergraph inquiry to date. In the superstar image driven world of ‘Jeff.com’, individuals such as Williams, Walker and Matheson seemed to flourish. Whilst we seemed to have largely avoided the bargain basement asset prices seen in the UK, those in rural areas whose services had been contracted to companies outside the rural township did see their own local economies downsized. Likewise, those who used to spend their time delivering human services in cooperative arrangements saw a new, but more aggressive competitive streak emerge which often allowed less time to actually deliver services and more time complying with tendering

\(^5\) Asset sales proceeds were not as poor as those in the UK, but the good prices for electricity assets must tempered against the giveaways of Tabcorp, HRL & AHPlant. In the cases of the Tabcorp alone, a wealth transfer of around $3.2billion to the private sector was estimated by Walker and Walker (2000). We might also comment in passing that the excellent prices for electricity assets were also more due more to market sentiment and the expected ‘light touch’ regulation regime being discussed informally rather than any explicit government design. Put simply, Victoria was seen by international investors as being the first domino to fall in the national competition policy driven frenzy to sell off Australia’s electricity assets.

\(^6\) The number of residential customers disconnected for non-payment has apparently fallen by around two thirds since 1995, with business disconnections being halved over this time. Both of these performance results are impressive, though not without criticism. Romeril (1997), for instance, argues that disconnection figures for the state owned monopoly as at 1994 are an inappropriate benchmark, these being around 75 percent higher than those of the state facility two years previously.
systems and contracting transactions. More control and direction, but less service delivery.

Second, it was argued earlier that privatisation without good governance can lead to a corrupt state. The Kennett sales agenda, like those of the United Kingdom, New Zealand or Mexico, was ruthless and swift. In Victoria, no instances of financial corruption were uncovered by the Audit Review which recently reported on a small sample of transactions, although some were noted as being ‘of concern’ and as being a priority for further investigation. These transactions appear to have been legal and therefore clean, but in any event, the ‘Charter for Good Governance’ had itself already become a central lever in the formation of the new Bracks government. This was clearly a measure of the extent to which Victorians believe that the fabric of good governance had somehow itself become subservient to ideological privatisation and contracting transactions. Our values in Victoria, it appears, had been temporarily suspended upside down. The values underpinning privatisation were also those same ones which were silencing the Auditor General, sacking Accident Compensation Tribunal judges, enacting a bill to remove the right of citizens to review government decisions to close schools in the state, removing the independent Public Service Board, removing the Director of Public Prosecutions, ousting autonomous local government, watering down F.o.I. laws and removing ‘some 100 odd avenues citizens had pre-Kennett to recourse to the Court for redress’ (Russell 1999). Privatisation, it appears, was just part of a bigger culture of governance as domination and control – if you didn’t like the judgement made by an independent check or balance – remove it! Such a culture was inconsistent with good governance if we follow the definition of ‘transparent, just, fair and democratic’. Perhaps the visible reality of Victoria was not so much corruption in the sense of systemic financial payoffs, but the more sinister and obsequience influence peddling and shadowy world of private capital – the use, some have even hypothesised, of state resources to establish multiple projects around the city to enhance the profits of a Casino and a Grand Prix Event. Perhaps it was corruption of our assumed democratic processes rather than the financial? At the very least, we might conclude that the democratic dimension of ‘good governance’ lost some of its sheen through this period.

Third, power rather than economics seemed to drive the process from international experience. The Kennett government also went way past its privatisation election mandate in both breadth and depth. Its actions became increasingly unresponsive. It centralised power in a few people and out of the hands of even the traditional Parliament. It removed some of the traditional
balances where it could. It provided an influential and valuable place at the State’s table for business. A compliant public service was shaped. A quiet civil society silenced by the barbs of contract conditions and financial deterrents was encouraged. Questions or comments were simply not welcomed, and bullying overtones usually accompanied any person seeking discussion or answers. Independence was shunned and secret deal-making was rewarded. The privatisation party in Victoria, which had been fanned along by the unique lever of National Competition Policy, had catapulted the state to the position of fastest privatiser on earth, but was being watched by an acquiescent public sector and an increasingly bewildered and shocked community. Not only did the breadth and depth of enterprise sales in the state not have the popular backing of citizens, the implementation of CCT in rural areas did not deliver local or regional benefits. The response of the government was, at best, slow in the midst of any such questioning, and we also saw power to institute changes reduced for future governments through long term contracts.

Disappointingly, we witnessed a remarkably lax attitude to the stewardship traditionally seen as part of government. Less than one third of the six major contract cases reviewed in the recent Russel Audit Review reported an initial economic evaluation, and in not one of these six cases was a social or regional impact analysis undertaken up front (Russell, Waterman & Seddon 2000). Whilst we all adopted the language of outcomes and outputs, inputs and process, some of the highest priority outcome evaluations in our history seemed to be simply ignored. The positives were advertised and assertions were marketed. Today, Victoria’s $33b sell-off is still greeted with uncertainty as to whether all citizens benefited from this period of discipline as former Treasurer Stockdale suggests, or whether the government fell asleep in the middle of a massive heist estimated to be in the order of $48billion for a selection of just seven companies around Australia by Walker and Walker (2000, p. 24). Considerable uncertainty surrounds perceptions of the truth, here. No doubt the truth is somewhere between these two extremes. But we all ought to know, as a matter of priority. A willingness to open up and investigate in an independent manner questions such as this are a key part of the good governance foundation, and working towards clearer answers on these issues is a central accountability requirement for fairness.

Whilst the economic benefits of privatising our utilities in Victoria are likely to have at best been modest, along with global experience, it is also recognised that this argument can be shaped both ways depending on our political persuasion. Those against privatisation transactions will argue, correctly, that significant improvements in economic efficiency have not been delivered as
promised. Those against, will argue, again reasonably, that government ought not be involved in any business which is just as well done by the private sector, particularly given the increasingly difficult and complex pressures which governments now face in this age of globalisation.

Overall, we might simply comment that any judgement as to the 'fairness' or otherwise of the selling enterprises in Victoria requires some independent economic figures to be produced which clearly identify the economic gains and losses for the state in total and, as well, identify those groups who have indeed won and those who lost.

Accountability was seen as a casualty in international privatisations, with reduced transparency. The experience of Victoria has been a little more positive perhaps but still mixed. I suspect that some of the accountabilities have improved, such as those for financial returns, asset usage or the measurement of service outcomes. At least we knew before the sales what electricity assets the state actually owned and what their value was. At least transport service parameters were being written down. Paradoxically, however, one might suspect that other parts of accountability were simultaneously reduced, with Parliamentary accountability appearing to take a nose dive. The institution of Parliament lost its traditional public interest primacy and leadership role. We witnessed a downgraded role to Parliamentary Committees, which ran at a snails pace through the Kennett years, and saw Ministerial answers being shielded by the weapon of commercial-in-confidence. Concomitantly, it strained its relationship with Parliament’s Auditor General, and by orchestrating minimal sitting days and stunted debates, it reduced the transparency of its operational links with the state’s executive and the media.

Of course none of us would argue that the former SECV was perfect in its accountability arrangements, having been characterised as an engineering dominated, supply driven culture in the midst of huge political sensitivities around both energy demand requirements and industrial relations. However, with the privatisation of utilities in Australia such as the SECV and Telstra, a noticeable feature was the change of rhetoric from the former criticism of these institutions being ‘engineering driven’, ‘on a supply-kick’ or ‘being over-engineered’ to the post-sale rhetoric of being ‘valuable assets’ and the significant proceeds providing wonderful benefits of various sorts.
Conclusions

In this paper, it is concluded that there were several general lessons evident from the international experience in privatisation. Most of these lessons were seen as having direct relevance to Victoria, and importantly, nearly all of these had implications on the fabric of good governance. The effects of the state’s privatisations on good governance were viewed as mixed, with sales generally being more sophisticated than elsewhere and probably with smaller direct losses to citizens than we might have otherwise have expected. The values underpinning this program of enterprise sales, however, did lead to a shortfall in good governance in terms of transparency, fairness and traditional democratic mechanisms. Of most concern was the conclusion that, in the absence of any independent state-wide evaluation of the welfare effects of Victoria’s sales, no-one is actually well informed yet as to the probable impacts on Victorian citizens of the privatisation experiment.

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