

## Truth and fiction in the nationalisation vs privatisation debate

Rip van Winkle was a fictitious American character who fell asleep for twenty years. When he awoke he was blissfully unaware of developments that had occurred in the meantime. The new South African debate on nationalisation versus privatisation seems to be dominated by latterday Rip van Winkles who have been asleep for not twenty but fifty years.

Almost all the developed countries of the world admit that most of their experiments in nationalisation have proved dismal failures. Governments everywhere are selling off inefficient, loss-making State corporations to the private sector. But South African economists attending a conference in Harare on a post-apartheid economy during the first week of May declared that concerted action should be taken to resist the "immoral and unacceptable" measures of privatisation and deregulation.

African National Congress economist Vella Pillay said: "Demonstrations of mass indignation could make it extremely difficult to privatise because that would reduce possible buyers. A firm position taken by the ANC and Cosatu that a future government would re-nationalise would itself be an obstacle to privatisation as it would discourage potential buyers."

This article will attempt to show that nationalisation would present a future South African government with numerous, probably insurmountable problems. It will also provide a critique of the anti-privatisation arguments currently doing the rounds.

### The how and what of nationalisation

The ANC, NAFCOC and others have recently launched a welcome series of initiatives to consider *what*, if anything, should be nationalised. But thus far there has been almost no discussion amongst the advocates of nationalisation on *how* to nationalise. On the face of it, it seems sensible to resolve *what* should be nationalised before considering the details of *how*. But on further deliberation it becomes obvious that the questions should be asked and answered in the reverse order. Whether nationalisation is a good idea, and in what way it could help blacks (which is presented by its advocates as its main purpose), will depend entirely on *how* it is done, and indeed whether it can be done with any success at all in the real world of the 1990s.

Even in the unlikely event that a nationalised undertaking is efficient and free of corruption or debilitating political patronage and manipulation, other unavoidable disadvantages tend to outweigh benefits.

To consider some of the difficulties that lie ahead, one need only imagine being Minister of Finance in a future ANC or PAC South African government. You want to nationalise the banks. Do you nationalise all the shares or only a controlling interest? Do you confiscate shares with or without compensation? If the former, how much should the compensation be and where do you find the money? If the former, do you purloin all the shares or only those of major shareholders? How do you justify discriminating against investors in some companies but not others? What do you do about foreign-owned banks, or shares held by foreigners, and so on? Let us look at some of these problems more closely.

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### Confiscating without compensation

If shares in a given company are being confiscated without compensation, will they all be confiscated including those of small investors? If so, they may represent the life's savings of a labourer, or the inheritance of an impoverished widow. They may belong to a black person who is on the way to becoming economically empowered, or they could be the investment of worker's pension fund savings, or trade union funds.

If a little person's shares in one company are confiscated, he will feel unfairly treated by comparison to other, more fortunate investors with shares in a company remaining in the private sector.

One solution would be to nationalise everything without compensation, and have an equal distribution of injustice. But so far no prominent person has suggested this.

Alternatively, there could be a means test to ensure that only the shares of "rich" people, or of people with more than a certain number of shares, are filched. Or perhaps only the shares of whites would be taken without compensation, on the grounds that "whites acquired their wealth unjustly". But what of whites who clearly did not do so . . . who acquired their wealth in precisely the same way as a black person? For instance, what of a white person operating a taxi, who started with nothing and entered the market at the same time as a black taxi operator? Could confiscation be promoted as a blatantly racist policy? What would the consequences of these alternatives be?

Confiscation without compensation, no matter what its form, would be tantamount to deciding that there should be no meaningful future inflow of capital, technology or expertise from the West, at a time when injections of capital and expertise can clearly no longer be expected from the Eastern Bloc. Moreover, it would be a major disincentive to further domestic investment. The very possibility of confiscation without compensation occurring under a future regime would drive vast amounts of existing human and financial capital out of the country well in advance of nationalisation. Finally, such measures might be the straw that breaks the camel's back, leading to insurrection by the "white right". It seems clear that these and countless other harmful effects of confiscation would far outweigh any intended benefits.

### Confiscation with compensation

The official ANC position on nationalisation is that it will definitely occur *with* compensation.

Nationalisation with compensation is as hard to achieve in practice as it is easy to call for in theory. This is the lesson the National Party learned on the two occasions it came to power on pro-nationalisation and anti-capitalism platforms. In the event, very little was nationalised and those enterprises which were taken over were relatively small. (The present vast size of the State corporations is due largely to the redistribution of immense amounts of money from ordinary South Africans to the State.)

There is a prevailing myth about the potential for increased or improved wealth redistribution in South Africa. Apparently few realise how much redistribution already occurs. Government critics who call for more redistribution argue that the "cost of apartheid" is excessive, without realising that most of that

cost is incurred in redistribution from white/rich to black/poor along the same lines they themselves propose. During the 1980s government spending on social and infrastructural upgrading in black areas reached extraordinarily high levels by any international standards. (See *Let the People Govern*, Amagi, 1989, pp 194-198.)

South Africa is one of the most redistributive countries in the world and most of the present redistribution is of the kind recommended by socialists. Cynics argue that the present level of redistribution is motivated by the government's desire to "bribe" blacks into acquiescence and compromise. But whatever the underlying reasons, there is not much scope for improvement. Don Caldwell has shown in *SA: The New Revolution* (Free Market Foundation, 1989, pp 60-72) that claims to the effect that substantial sums can be diverted from defense and the abolition of the tri-cameral system are groundless.

In sum, however much money a future government might have to spend, there will be nowhere near enough to finance the social programmes ANC or PAC spokesmen talk about, let alone the cost of compensated nationalisation. Moreover, every cent of money spent on nationalising or expanding a State undertaking is a cent diverted from some alternative such as building schools or clinics, providing pensions or supporting a rural development scheme.

These unavoidable truths have curtailed nationalisation in Zimbabwe and are giving Swapo serious food for thought in Namibia. At a recent IDASA conference on Namibia, representatives of the National Union of Mine Workers (NUM) were very visibly distressed on hearing the Secretary-General of their Namibian counterpart explain why his union would not advocate a minimum wage law or nationalisation, at least for the time being.

Any future Minister of Finance is going to be under enormous pressure to increase the present level of government redistribution of wealth to blacks substantially. Calculations based on the amount of wealth available reveal that this cannot be achieved by any method proposed so far, except, ironically, by privatisation.

#### At what price?

If assets are nationalised with compensation, will this be done at the market price? That is, will the government purchase shares on the open market? If this is the plan, as soon as it becomes generally known, share prices will be driven artificially high, forcing the State to pay more than the shares would have been worth but for nationalisation.

Alternatively, the government may try to negotiate the rate of compensation. If agreement cannot be reached, how will prices be decided? Perhaps by decree or by arbitration. If prices are fixed by decree, enormous uncertainty and disruption will be generated in financial markets. If they are low, the self-interest of investors, shareholders and managers alike will lie in stripping companies of cash and other assets. Moreover, new investment will all but cease, and companies will have no incentive to retain earnings for such purposes as staff development, and the maintenance and replacement of machinery. If decreed prices are high, the State will not have the money to pay them. Moreover, if the amount of compensation is to be fixed by arbitration, who will arbitrate? Is it possible to arbitrate a price so accurately that the State avoids paying either too much or too little, and thus avoids disrupting the economy unduly?

#### How much to nationalise?

Will nationalisation be of an entire enterprise or of only a con-

trolling interest, which in some companies may be as little as 5%? If only part of the shares is taken over the State, this is likely to cause serious damage to those whose shares are not nationalised. Investors will – with good reason – expect the capital value of, and return on, their shares in a nationalised industry to decline. If they dump their shares on the market, the price will be depressed and they will lose through no fault of their own. Furthermore, as the value of the shares drops, the government's ability to raise capital from its newly acquired interest will be diminished.

Paradoxically, it is not those investors whose assets might be nationalised who should be particularly concerned. The ones who have the most to fear are those who will be left holding onto their investments in a deteriorating economy.

#### Making losses

At present, most government money comes from private sector taxes. In South Africa and elsewhere, nationalised industries have tended to consume rather than to supplement government revenues.

Does it make sense to use corporate revenues to buy corporations, when the likely consequences are that revenue sources will dry up and the newly nationalised corporations will eventually require subsidies to keep going? The new State will find itself with reduced revenues, and those still generated will be swallowed by subsidies instead of being available for social programmes.

There are countless examples of this negative spiral. The nationalisation of British coal mines and Zambian copper mines provide first and third world illustrations. In both:

- profits became losses, as the political motive replaced the profit motive;
- an erstwhile source of revenue started consuming revenue, as subsidies replaced taxes;
- employment dropped both in absolute terms and in relation to tonnages, as technology replaced people;
- relative wages declined;
- foreign exchange earnings declined in real terms;
- inefficiency crept in as the incentive system changed.

#### Which companies to nationalise?

The Freedom Charter calls for the nationalisation of mines, banks and "monopoly industry". Does this include all mines, many of which are quite small businesses? Does it mean only banks, or all financial institutions? Most financial institutions (and many banks) are in no sense part of the "commanding heights of the economy".

What is monopoly industry? The most oft-cited example is the Anglo American Corporation. Yet in everything it does it operates in highly competitive markets, with the single exception of the international marketing of diamonds through the Central Selling Organisation (CSO). Since the CSO is internationally based it is probably not possible for South Africa – or any other State – to nationalise it.

SA Breweries (SAB) is also commonly described as a monopoly. But like Anglo, in everything it does – with the exception of beer retailing – it operates in highly competitive markets. As far as beer is concerned there is now relative freedom of entry for competing breweries and even for importers, but regrettably not yet in retail sales. Over the years many would be competitors have entered the beer market: Whitbread, Carling, Stag, Luyt, etc. They have been unable to match SAB's excellence. If this kind of "monopoly" is nationalised what will

the justification be? That it has served consumers, most of whom are black, too well?

### Who will the new owners be?

The basis for the current nationalisation debate is the popular myth that the Freedom Charter calls for nationalisation. It does not. It demands that "The mineral wealth beneath the soil, the Banks, and monopoly industry shall be transferred to the ownership of the people as a whole." *Ownership by the State is not ownership by the people*, as Joe Slovo and other socialists now acknowledge. Private ownership is ownership by the people, especially if it is widespread as the free marketers advocate.

Ownership by the people could mean many different things: co-operative ownership, participative management, State control of private companies, co-responsibility or Employee Stock Ownership Schemes (ESOPS). Slovo has recently argued that State control is more important than State ownership. Increasingly trade unionists, having observed the impotence of trade unions in countries with widespread nationalisation, are tending to prefer some form of effective participation in management. A few have noticed that the most effective unions with the highest wages, best working conditions and lowest unemployment tend to be those where there are a minimum of labour laws and a maximum of free competition amongst employers for their labour – that is, with the opposite of nationalisation.

### Back to the how and what

Let us return to our imaginary Minister of Finance. On the appointed day he tells his Nationalisation Commissar to go and nationalise the "mineral wealth beneath the soil". His trusted servant returns crestfallen to report that this has already been done. Indeed, since the turn of the century numerous measures have been taken to ensure that the minerals are owned by the State. These laws were consolidated in the Mining Rights Act (No 20 of 1967).

The minerals already belong to the State, but until now they have been subcontracted by the government to the competing mining houses under mining leases. The reason for this is that provided the State negotiates a favourable lease formula and imposes high taxes on mine profits, it stands to make much more money than if it mines the minerals itself. The State collects a good share of the profits (up to 75%), whilst private investors take all the prospecting risks and provide the massive amounts of capital required to develop the mines. To nationalise the sub-contractors (mining houses) themselves would defeat the object of the exercise. The governments of Ghana, Zambia and Zaire nationalised their mining houses and lost untold millions. Now they are reprivatizing the mines.

Our Commissar now turns his attention to the two biggest financial institutions, Old Mutual and Sanlam, which are also said to control most of the mining houses. Here he faces an even bigger problem because it turns out that Sanlam and Old Mutual have no shareholders. They are owned by millions of policy holders, a growing number of whom are black. Indeed, the Commissar reports, so few policy holders arrive at AGMs that blacks could easily control these institutions now. If, for instance, COSATU were to gain proxies from a small number of its members it could gain a controlling vote. If these two towering giants were confiscated it would cause an outcry amongst the black policy holders who would have more to lose than higher income whites with a spread of investments.

And what about the banks? They turn out to be owned by the institutions the government has already decided not to nationalise, or by foreign investors the government would prefer to stay in the country, and invest more than at present.

### Myths about privatisation

The public debate around privatisation has produced a number of myths which I will attempt to debunk.

*State monopolies should not be privatised because they will become private monopolies which will be even worse.*

The fallacy here is the assumption that when a State monopoly is privatised it will remain a monopoly. Firstly, State monopolies can easily be ended (even without privatisation) by removing the laws which protect them from competition. For instance, SAA would cease to be a monopoly if private airlines were allowed to compete with it on major routes as is presently being mooted.

Secondly, State monopolies can be privatised so as to provide opportunities for small business rather than remaining one giant company. For example, SATS could sell rail-tracks, stations, coaches and/or engines separately as has been done in other countries. Small investors could buy sections of track, as has already happened with the Banana Express in Natal. Individuals could be owner-drivers of their own engines. They could book track and station time and offer towing services to coach or truck owners carrying goods or passengers.

*Privatisation would lead to higher prices because there would be no more subsidies.*

One of the advantages of privatisation is that many State businesses which are presently subsidised would not receive subsidies in the private sector. But certain privatised services, for example hospitals and schools, would probably continue to receive State funding. In these cases the question to be asked is: would the private sector do a better job than the State *with the same subsidy*? The world's experience shows that the answer is invariable "yes".

*"Natural monopolies" cannot experience the benefits of competition.*

Here it is necessary to question the concept of natural monopolies, which is based on the idea that in some areas of the economy, for example in the provision of electricity, it is "natural" to have one supplier only.

Presumably if such monopolies were "natural" there would be no need to protect them by statute from competition. Moreover, superficial research reveals that all so-called natural monopolies operate under conditions of effective competition elsewhere in the world. Competing suppliers of drinking water, telephones, train services, and electricity are common in other countries.

*Privatisation leads to unemployment.*

This argument is particularly curious, because by implication it concedes that the private sector can achieve the same productivity as the government sector with a smaller work-force (or increase productivity without increasing the workforce). It is usually true that fewer people are required to achieve the same productivity in privately owned businesses than in State corporations, but privatisation does not bring about unemployment. On the contrary, it encourages rapid growth in the economy – and this results in more jobs in all sectors.

### The new racism

A new form of patronising racism has crept into the privatisation debate. Everyone, from the government through the DP, to economists and businessmen who used to favour privatisation, seems to be back-tracking. Growing numbers of prominent people are being reported as saying, in effect, that privati-

sation should be discontinued and the case for nationalisation partially conceded because this is apparently what most blacks want.

What this amounts to is that if enough black people are wrong about something, the expedient thing to do is to go along with them because they are not likely to change their minds when presented with the facts. This is insulting to blacks and untrue. Most of the Free Market Foundation's members are black, and in its training programme more than 600 black trainers present the case for free markets, including privatisation, to

hundreds of thousands of other blacks. These trainers find that many of their students are in favour of privatisation to start with, and most of the balance happily change their minds if they find the arguments against State ownership convincing.

Even if it is not possible to convince the majority of black South Africans of the inevitable disastrous consequences of nationalisation before they become voters, analysis suggests that the practical problems facing a government bent on nationalising a significant part of the South African economy would be so great that it will probably never happen.

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