TURN-OF-THE-CENTURY CHANGE IN NEW ZEALAND'S PUBLIC ENTERPRISES

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Abstract

The New Zealand reform agenda of 1984-1999 included a significant redefinition of the role of the state. Many public sector activities were restructured in corporate form. Policy and operations were largely separated. Privatisation was extensive. The change of government at the end of 1999, to a centre/left coalition, has seen a major reappraisal. Privatisation is out of favour. SOEs are to be managed to enhance shareholder value, with authority to grow their businesses. The government is reasserting the social objectives of crown owned companies in areas such as health, housing and public broadcasting. This paper explores the implications of these shifts and suggests that the SOE model, and the rationale for using the company form more generally in the public sector, may now be under challenge. Reasons include an apparent lack of understanding of the nature of the corporate model and renewed political risk because of the difficulty of separating out political and commercial reasons for public investment.

Introduction

The period 1984-1999 in New Zealand was one of major public sector and economic reform. Comprehensive restructuring included a significant redefinition of the role of the state and, flowing from that, the state's withdrawal from a number of activities that had previously been seen as the core business of government. As an OECD report (1999) puts it, the underlying philosophy was that "the state should do and/or fund only those things relating to the exercise of its constitutional and coercive powers and/or those things where it has a comparative advantage".

The reform agenda was actively pursued by the Labour party which came to power in 1984, and subsequently built on by the National party which replaced Labour in 1990. The scope and magnitude of the reforms, and the relative haste with which they were introduced, attracted considerable overseas attention and applause. As Kelsey (1995: p. 5) records, the "radical adventure captured the imagination of the international economic community, whose institutions and organisations provided a chorus of support". Kelsey (1995) dubs the reforms "the New Zealand experiment", and Boston and his colleagues (1996) label the institutional elements "the New Zealand model".

A key component of the reforms was that trading departments and some other bodies with commercial or quasi-commercial interests were corporatised as limited liability companies and later, in several cases, partially or fully privatised by way of divestment. The specific initiatives, as well as those in relation to the core public service, public finance, and purchaser-provider arrangements, have been well documented and analysed in other studies, so most of them need not be addressed in this discussion (see e.g. Boston, 1995; Boston, Martin, Pallot and Walsh, 1991, 1996; Duncan and Bollard, 1992; Easton, 1989, 1997; Kelsey, 1995; McKinlay, 1987, 1998, 2000; Schick, 1996; Scott, Bushnell and Sallee, 1990; Spicer, Bowman, Emmanuel and Hunt, 1991).

Many of the country's public enterprises are now structured as companies which are registered under the Companies Act but also governed by other important legislation of immediate significance of their operation, control and accountability. In terms of the latter legislation and the associated ownership arrangements, they fall into three categories. The first category comprises a number of "state-owned enterprises" (SOEs) which are subject to the State-Owned Enterprises Act and are expected to function very much like and in competition with private business enterprises. This category is well known internationally. Several SOEs have been divested, such that by the mid-1990s New Zealand was one of the world's leading privatisers.[1] The second category consists of various "crown-owned companies", such as Housing New Zealand Limited (Ltd), the "crown health enterprises" (which existed from 1992 to 1998), and the "crown research institutes", with the legislation concerning their business and social obligations being the Housing Restructuring Act, the Health and Disability Services Act, and the Crown Research Institutes Act, respectively. The third category includes the local government equivalents of the SOEs. These are "local authority trading enterprises" (LATEs) which are owned by local governments and run pursuant to provisions of the Local Government Act.

The discussion here covers enterprises in each of these three categories. Of particular interest are developments and trends over the period since the last general election in 1999.

A Change of Government

In late 1999, the National party (which by then was in power as a minority government) lost office to a coalition between the Labour party, as the dominant member, and the Alliance party which is ideologically to the left of Labour. The Labour party (1999a) had campaigned on a platform that:

Labour will not engage in a programme of privatisation of state assets. Labour supports the state owned enterprises model because SOEs are efficient, profitable, and owned by the people of New Zealand. Labour does not see SOE status as a halfway house to privatisation but a sustainable, permanent mode of operation.

This policy commitment was confirmed in the Governor-General's "Speech from the Throne" at the opening of parliament for the year 2000 (following the 1999 election). The speech included the statement that:

My government will not have a state asset sales programme. Accordingly, Treasury has been instructed to cease all work on options for implementing such a programme. It will be made clear to the Boards of SOEs and other commercial organisations that their job is not to prepare assets for sale but to enhance their value and ability to contribute to economic and social growth and development as state-owned entities.

Clearly, a major change was heralded in the relationship between the state and its public enterprises. The change is still evolving and is likely to do so for some time yet. Nevertheless, there is already enough evidence for this discussion to consider the shape of things to come. This is especially so concerning the organisation and management of public housing and health facilities, along with a few other areas of public enterprise activity.

Several important lessons can be drawn for the experience to-date, with questions rightly being raised about the robustness of the company structure in cases where a government has significant non-commercial policy objectives at stake. It seems clear that it is not feasible to combine commercial and social objectives in the one organisation constituted in the company form.

Housing and Health Facilities

State Housing

In 1992, the National party government restructured its policy and operational interests in housing. The former Housing Corporation of New Zealand, which had combined a policy advisory role with the provision of state rental housing (involving approximately 67,000 rental units) and subsidised mortgage lending, was stripped of most of its functions. The state housing portfolio was transferred to a newly-created state-owned company, Housing New Zealand Ltd, which was then expected to operate as a successful business in its role of providing housing for low-income members of the community. The policy advisory role was passed to a new Ministry of Housing, consistent with an emphasis on separating responsibilities for policy advice and implementation. The Housing Corporation was left with residual roles in providing mortgage finance for groups with special needs and rental housing (on market terms) for community groups. Its primary function was to continue the process of selling-off the state's substantial portfolio of low-income mortgages.

In respect both of subsidised rental housing and of low income mortgages, the government was of the view that the need targeted by its housing programs was one of ability to pay and thus was best addressed through the social benefit system. Rentals on state houses were increased to market rates, as were interest rates on low interest mortgages (except in those few cases where the mortgage document did not include an interest review clause). The existing forms of assistance were replaced by an accommodation supplement available to all home occupiers regardless of the ownership of their houses or the origin of their mortgages.

As part of the restructuring of its housing interests, the government extracted significant capital from Housing New Zealand by requiring it to borrow on commercial markets and to return capital as part of a policy of minimising the government's investment in housing. The company was also required to reduce its housing stock through various sales programs, including a partly-subsidised program of selling houses to existing tenants and on the open market.

The Labour party's 1999 election policy included a commitment to return to an income-related rental for state housing tenants, and effectively to reverse the former government's restructuring of its housing interests. In conformity with this commitment, the Labour/Alliance government took three initiatives. First, it amended the Housing Restructuring Act to state that the principal objective of Housing New Zealand is to "help meet the Crown's [government's] social objectives by providing housing and related services in a businesslike manner". The purpose of this change was to remove the company's profit-focused objective of operating as a successful business. Second, the government abolished market rentals for state housing tenants and replaced them with an income-related rental set at 25% of income. Third, with effect from 1 July 2001, it recombined its housing interests in a new statutory corporation, Housing New Zealand Corporation. This body is now the government's principal policy adviser on housing, with Housing New Zealand Ltd structured as its subsidiary. It employs all housing staff, both for itself and for Housing New Zealand.

The latter change reverses the policy/implementation split which had been put in place by the previous government. It reflects the perspective of the Labour/Alliance government that advice on housing policy had suffered because policy advisers were too remote from day-to-day operations. This had led to their having only a limited understanding of operational concerns and of the needs and circumstances of people approaching Housing New Zealand for assistance.

The change also marks an important evolution in ministerial attitudes. The Minister of Housing in the Labour/Alliance government came to office with a conviction that the use of a company to own the government's rental housing portfolio was quite wrong. In his view, state housing is a social service and the use of a commercial structure is inconsistent with this.

The minister was subsequently persuaded to accept that Housing New Zealand should remain a part of the arrangements, for two reasons. One was that it had raised in excess of NZ$1 billion from commercial lenders under a series of bond issues, and any restructuring of it could trigger a demand for repayment which would require the government itself to recapitalise the company or otherwise secure the funds to repay bond holders. The other reason was that the use of the company structure provided him with considerable flexibility. As the company was to an extent at arms length from the government, it could be a vehicle for undertaking activity without necessarily coming under the scrutiny of the Treasury or requiring an appropriation from parliament.

These were both pragmatic considerations. Neither suggests an acceptance that the company form itself has the potential to add value, for example by imposing a discipline on asset management any more effectively than can be done within a departmental structure or a statutory corporation.

Public Hospitals and Related Services

Health sector restructuring has been a persistent theme in New Zealand's public sector reforms. In 1992, the National party government abolished the part-elected part-appointed area health boards which were responsible for running public hospitals and a range of other services. Public hospitals were converted into crown health enterprises (CHEs) as limited liability companies owned by the government and operated within the framework of the Health and Disability Services Act. The rationale for the change was that "establishing hospitals and other major area health board services on a businesslike basis will allow managers to get on with the job of running hospitals and other services efficiently, and will allow health professionals to work in a better organised, more professional environment" (Upton, 1991).

The use of the company form was controversial from the beginning. Doubts were expressed about the appropriateness of companies when, for the most part, the health market was not contestable. Public hospitals were effectively monopoly providers for most of their services, and the principal purchaser of those services was the government acting effectively as a monopsonist. Also, the use of a for-profit structure was inconsistent with the values of many people working in the public health system.

In its health policy statement for the 1999 election, the Labour party (1999b) rejected the commercial model, stating:

Sadly, National has allowed our public health system to be run down, privatised and commercialised in the name of so called "health reforms". The result of these reforms has been the overwhelming alienation of the public which, in turn, has led to cynicism about our health services . . . [The system] is neither accountable to central government nor to local communities - *the only accountability measures which are regularly reported on or monitored relate to financial rather than health service quality indicators* (emphasis in original).

Consistent with these views, the Labour/Alliance government has replaced the company structure for hospital services with district health boards constituted as statutory corporations.[2] These boards are to be part-elected (in an attempt to introduce an element of local accountability) and part-appointed. In transition to this status, several of the former CHE directors have been replaced by government appointees selected for their community credentials rather than their commercial skills, with a particular emphasis on appointing Maori (the indigenous members of the society).

The government's policy in the health sector represents its strongest rejection of the company form on the grounds that profit-oriented structures are inappropriate for the delivery of social services. For a time, it appeared that this rejection would extend to the way in which hospitals manage all aspects of their affairs. The chairperson of a former CHE has spoken of a meeting at which the Minister of Health told him and his board that the government not only was going to abolish the company arrangements for hospitals, but also would direct the new organisations not to use the company form for subsidiaries (personal communication, 2000) This view, however, has now changed with the Minister accepting that subsidiaries can be a useful vehicle for hospitals to manage parts of their work, especially in the case of joint-ventures.

Interestingly, Scott, who was Secretary to the Treasury at the time of the National party's health reforms, now shares the view that the use of the company form was inappropriate for hospitals and some other activities. He (Scott, 2001: p. 71) recently noted a shift to readdress areas where the methods of the 1980s were used inappropriately, either in conceptional design or implementation. In some instances, the issues arose from inadequate analysis of complex systems due to poor strategic policy analysis, leading to poor decision making, sometimes followed by poor execution of the reform. An example is corporatisation in situations where the basic technical conditions for improved efficiency were absent. Corporatisation of hospitals and the National Electricity Transmission grid are examples.

A Selection of SOEs

The main principles concerning public enterprises governed by the State-Owned Enterprises Act are that they should be established on an arms length basis from the government and enabled to operate in such a fashion that state ownership is neither an advantage nor a disadvantage. These principles are expressed in an OECD report (1999) as meaning that "fully commercial functions that remain the responsibility of the State should operate in private sector and competitively neutral forms under the governance of boards of directors, paying tax and dividends".

Towards the end of the National party's time in office, the SOE model was coming under some stress. There were growing concerns over the possibility of political interference in the appointment of directors.[3] There were also concerns that the government's reluctance to provide further capital for its SOEs and/or to contemplate substantial extensions of their business was standing in the way of normal commercial operations.

The policy approach of the Labour/Alliance government is emerging only slowly and on a case-by-case basis. Generally, the government seems to be acting in ways consistent with the principles cited above, but there are concerns that, in a different way from its National predecessor, it may be re-politicising the SOE environment and increasing the risk to the tax payer. Four examples illustrate current trends: New Zealand Post, Meridian Energy, Television New Zealand, and Terelink (which is responsible for surveying and land information).

New Zealand Post

The core business of New Zealand Post is that of running the country's main postal service (in addition to its having extensive courier interests and a major international consultancy business). Its business has been coming under increasing pressure from the competition of new entrants as postal services have been deregulated, and from an increasing use of the Internet. The result has been a decline in mail volumes and a significant reduction in profitability that has encouraged its board of directors to look for new business opportunities.

The company has seen such an opportunity in the banking sector. Its predecessor, in the days when it was still a government department, ran the Post Office Savings Bank which for a time was the country's single largest savings institution.

The major part of the banking sector in New Zealand is now overseas-owned, primarily by Australian banks but with British, US and other banks also involved. As elsewhere, banks have been drastically rationalising their services, closing uneconomic branches, encouraging the use of telephone, electronic and automated services, and revising their fees to remove the cross subsidies which previously favoured small customers. The dominance of overseas ownership, the cases of high profitability, the withdrawal of services, and the increasing cost to small customers have collectively created quite strong public antipathy towards the banking sector, especially in communities which no longer have ready access to banking services.

For New Zealand Post, this antipathy appeared to provide an opportunity. The company still has a very extensive branch network, and many New Zealanders remember well the days when the Post Office also operated as the Post Office Savings Bank. Many were customers. Perhaps the business opportunity to restore its declining profitability was a re-entry into the banking business.

In parallel with this, the Alliance party as the junior partner in the government had as one of its policy commitments the creation of a New Zealand-owned bank. Politically, this was a direct appeal to those in the community who resent the way in which so much of the economy is overseas-owned, and a particular appeal to those who have lost banking services or find that these services are much more expensive than they once were.

The re-entry into banking soon became New Zealand Post's major business development strategy. Initially, its position was that this could be achieved without the need to call on the government as shareholder to provide additional capital. In early public statements on the matter, the Minister of Finance indicated that the government would not make additional capital available but would allow the company to re-arrange its balance sheets and assets (including perhaps the sale of its extremely valuable Head Office site) to raise the necessary finance.

In fact, it has proved impossible for the banking proposal to go ahead without an injection of capital and the government is now committed to providing NZ$73 million. Many observers see this as a cynical use of taxpayers' money with the Labour party as the senior coalition partner allowing its junior partner a major policy "success" as part of the price of maintaining its support.

Discussion of this proposal with two different ministers, one from the Alliance and one from Labour, suggests a different explanation but one which may, in the long run, be of more concern. As the Alliance minister has stated it, even though a government might have a strong ideological reason for doing something, in a commercial business that is not sufficient; it is also necessary to have a sound commercial justification. He has argued that a re-entry by New Zealand Post into banking is an example of the government's ideological and commercial objectives coming together. If the government owns businesses then it really has an obligation to allow them to act in a businesslike manner, and this includes providing additional capital when a sound business case is made for it.

The Labour minister has noted that on two occasions the previous government had accepted Treasury advice to decline a New Zealand Post request to undertake a substantial new business investment - a stance consistent with the then view that the government should be seeking to minimise its involvement in business. As this minister sees it, the government has a policy interest in the continuance of a robust national mail system. Since this is at risk because of the competitive pressures faced by New Zealand

Post and its declining profitability, the maintenance of the company as a viable business entity means allowing it to diversify to compensate for declining returns and market share in its main business. It is therefore appropriate for the government to agree to its entering into a new area of business and to provide capital for that purpose.

The government's stance overall is that the business case happens to support what it wishes to do. It is a happy coincidence of its ideological concerns (the provision of essential services to low-income New Zealanders and isolated communities) and a political reason (the senior coalition partner allowing the junior partner a political success).

The difficulty in terms of the integrity of the SOE model is that the additional investment involved has not been subject to a true market test. Clearly, politicians were keen to find a way of approving what New Zealand Post wished to do. The government's main source of advice on the commercial viability of the investment was the board of New Zealand Post itself. Documents released under the Official Information Act make it clear that the government's principal financial and economic advisers were extremely sceptical about the prospects for success. Banking commentators in New Zealand, both from within and outside the banking industry, have almost universally decried the investment as a waste of taxpayers' money.

In theory, it is entirely appropriate that a SOE should be able to invest in new business opportunities that meet or exceed an appropriate threshold rate of return. The difficulty, highlighted by the New Zealand Post example, is how to ensure that the analysis of new investment options is genuinely objective and that decisions by the government to provide further capital are as robust as those taken by equivalent private sector owners. In the absence of means for ensuring that this is the case, it is difficult to escape the judgement that SOEs may be at risk of becoming a vehicle for the very kind of politically-driven investment decision making which the SOE model was established to eliminate.

As well as its interest in banking, New Zealand Post has one other major diversification from its core business. This is the provision of consulting services internationally to other postal authorities through a subsidiary company, Transend. This company has obtained major contracts, the largest of which, with the South African Postal Service, is now in considerable difficulty. The South African government is seeking to terminate the contract, arguing that New Zealand Post has failed to perform.[4]

Through Transend, New Zealand Post has also expressed an interest in bidding to purchase other states' postal systems which are being divested. An example is the postal service of Trinidad and Tobago.

The board of New Zealand Post has recently undergone a quite major restructuring, with a number of new appointees replacing directors whose terms had expired. The new directors were appointed, presumably, because of a combination of relevant experience and views seen as broadly sympathetic to the government's objectives. The unintended result has been a virtual breakdown in the operation of the board. The new directors have strongly queried the wisdom of entering the banking business, especially as it is beginning to appear that the promised savings for future customers will be less than expected. They have also cast doubt over the operations of Transend. They see it is profiting at the expense of developing countries. In addition, they see a conflict in New Zealand Post, owned by a government which is anti-privatisation, itself bidding to purchase assets elsewhere through other governments' privatisation programs.

There was the prospect of a bitter feud between the long-serving chairperson of the board and other directors. The government's invention, in which it was made clear that directors would be dismissed if they could not find a way of working together and confining any disagreements to the boardroom, appears to have resolved matters for the moment. However these sorts of experiences raise the important question of whether it is possible for a government-owned company both to be commercial in its approach and to take full account of social objectives.

Meridian Energy

As part of its on-going endeavours to reform the electricity sector in the early 1990s, the then National party government made a number of changes in the structure and ownership of what had been the largest SOE, the Electricity Corporation of New Zealand Ltd (ECNZ). This company owned the national grid and very much the major part of the country's generation capacity. In 1992. the ownership of the national grid was transferred to a separate SOE, Transpower New Zealand Ltd. Five years later, part of ECNZ's generation assets were separated into a new SOE, Contact Energy Ltd, and on 1 April 1999, against the strong objections of its board of directors, ECNZ itself was broken up into three separate and competing SOEs. A month after this change, Contact Energy was privatised through the sale of a 40% shareholding to the US utility, Edison Mission Energy, and the public flotation of the balance of its capital. This sale led to the government's being strongly urged by the business community to float the remaining SOEs involved in generation. It is likely that, had the government been returned to office at the 1999 election, at least one (if not more) of those SOEs would have been privatised.

Meridian Energy is one of the three SOEs established following the 1999 dissolution of ECNZ. The company has recently purchased a portfolio of small-scale hydrogeneration assets in Australia for a total cost of a little over NZ$100 million. The investment required the approval of its shareholding ministers in the Labour/Alliance government. In announcing the investment, the Minister of State-Owned Enterprises said that pursuing legitimate business proposals is one of the principal functions of an SOE in order to add and consolidate shareholder value. Shareholding Ministers carefully consider all such proposals on a case by case basis. In this case, we believe the Australian investment fits well with the company's core business and expertise. The Government has a policy of retaining and growing SOEs for the benefit of New Zealanders. The strategic direction being followed by the Board and management of Meridian Energy reflects well this policy.

This is a case where there was no political motive for agreeing to the investment. Accordingly, it confirms the quite significant shift in policy from the previous government to allowing SOEs to undertake substantial business investments where there is a commercial rationale for doing so. It does not, however, address the concern raised in the New Zealand Post case that, where there is a political motive for supporting an SOE investment, this may override commercial considerations.

Television New Zealand

This company provides another example of the potential of the government's policies to intermingle political and commercial objectives or, at the very least, to create the impression that this is what may be happening. As such, there are similarities with the experience of New Zealand Post.

Under the National party government, Television New Zealand Ltd (TVNZ) operated as the country's principal free-to-air television broadcaster. Also, through some wholly-owned subsidiaries, most notably Broadcast Communications Ltd, it generated very substantial revenues by providing transmission services to third parties, including both other television broadcasters and telecommunication companies. The government treated it simply as another commercial business that happened to be in state ownership. The government's focus was on generating maximum revenue which, in turn, saw TVNZ take a very commercial approach to program content. Many New Zealanders saw this as an abandonment of the role of a public broadcaster for that of an essentially ratings-driven commercial business, caring little for the quality of its content so long as it maximised revenue.

In its election broadcasting policy, the Labour party argued that the expectation of New Zealanders was that TVNZ should inform them and promote debate on issues of concern to them. It also said that the company had a responsibility to reflect New Zealand life and culture.

In office, the Labour/Alliance government has been moving to require a change in direction on the part of TVNZ. It has recently introduced a broadcasting charter requiring it, among other things, to "feature programming along all genres that informs, entertains and educates New Zealand audiences" and to "feature programming that serves the varied interests and informational needs and age groups within New Zealand society, including tastes and interests not generally catered for by other national television broadcasters". There is also a strong emphasis on participation of Maori and the presence of a significant Maori voice.

These requirements will clearly have a major impact on the business of TVNZ. It is likely, for example, that its ability to generate advertising revenue will be dramatically affected. Rather than relying on commercial revenue to support its programming and broadcasting activities, it will of necessity be increasingly dependent on government funding. How this funding will be provided is yet to be decided.

The question raised for the Minister of Broadcasting and the government as a whole is whether the SOE framework will continue to be appropriate. With the charter obligations and the likely impact on revenue, it may not be possible to operate TVNZ on the standard SOE principle of being as profitable as equivalent private sector businesses. The same issue, however, does not apply to its highly successful subsidiary, Broadcast Communications Ltd (BCL). This company is not affected by the charter. It is simply a service provider, but one with an extremely valuable and increasingly profitable business.

For a time, the government considered separating BCL from TVNZ. This would have resulted in BCL's establishment as a separate SOE, and TVNZ's becoming a crown-owned company (outside the framework of the SOE Act), or even a statutory corporation, without the primary objective of meeting a rate-of-return target. From the government's perspective, this possible development was a rational response to the change in nature of the business of TVNZ. But some observers saw a more sinister motive. The loss of revenue which is bound to result as the charter obligations take effect might be largely offset by a relaxation of the profit requirement.[5] That was very unlikely to be the case if it also lost ownership of BCL and access to its profit stream. Almost certainly, this would have shifted TVNZ into a dependence on direct government funding.[6] For some, this was seen as a direct threat to the independence of TVNZ as a major source of news and current affairs. The fear was that a financially dependent TVNZ would gradually but surely become more and more reluctant to run news stories or current affairs programs that were likely to upset the government and perhaps impact on its future funding.

In the event, the government decided not to separate BCL and TVNZ as the minority coalition partner, the Alliance, refused to agree to this. Instead, TVNZ's status will change from a SOE to a crown-owned company, such that the SOE obligation of being as successful a business as equivalent private businesses will no longer apply. It will continue to own BCL as a subsidiary.

It remains an open question whether, under the new structure, TVNZ will be able to reconcile the commercial imperatives of operating the country's major free-to-air television channels with the charter obligations to accommodate minority and public interest programming. A number of observers believe that the government is simply being naive in its continuing insistence that TVNZ will remain viable under the new regime once it is no longer required to be a major profit-earner. An alternative implication is that the government has chosen to play down the impact to avoid having to debate the full fiscal cost of broadcasting, as well as the implications for TVNZ's independence from its becoming (as critics expect) totally reliant on government funding for its survival.

Terralink

Terralink was a relatively small SOE created out of the restructuring of the former Department of Survey and Land Information. It was formed to acquire what were seen as the more commercial aspects of the Department's operations, including its mapping and geological survey-based activity.

Terralink entered into a major contract with a private sector firm to provide services for a government project intended to computerise New Zealand's land title system. The contract went badly wrong, apparently because the management may have significantly underestimated the complexity and cost of the work involved. By late 2000, Terralink was in very serious financial difficulty and, in response to a request from it, the government provided it with an injection of capital as an advance secured by way of a debenture. Not long afterwards, receivers were appointed and Terralink was then placed in liquidation.

With hindsight, the government's initiative in advancing funds through a debenture at a time when Terralink was already in serious financial difficulty looked remarkably like the kind of hard-nosed approach which a private sector group would take to rescue elements of a failing business within the group at the expense of unsecured creditors and employees. The receivership is now virtually complete. The main element of the company has been sold to a private sector consortium. Unsecured creditors are unlikely to receive anything and employees have been told that there are no funds available to pay them their redundancy entitlements. The government will be repaid its advances but lose its equity.

All of this has happened under a government which came to office firmly opposed to the further sale of state-owned assets, and which has taken a strong stance on protecting the rights of workers, including expressing its concerns in some instances where private company failures have deprived workers of redundancy payments. The Minister of Finance has represented the government's position as one of regret, but of the need to make it clear that the government is not a guarantor of the obligations of SOEs. In essence, what the Minister has been saying is that the unsecured creditors and employees of Terralink are suffering a loss which is essential to preserve the integrity of the SOE model and to make it clear to creditors and others dealing with SOEs that they cannot rely on the government to bail them out. They must therefore be as prudent as they would be in dealing with a private sector company.

Local Authority Trading Enterprises

Early in 2001, the government introduced legislation to amend the provisions of the Local Government Act dealing with local authority trading enterprises (LATEs) which, as noted earlier, are the local government company equivalents of SOEs. A principal part of that legislation was to introduce a requirement that the directors of LATEs should have regard to both the commercial and the non-commercial objectives of their local government owners.

The background to this development was concern expressed in Auckland (New Zealand's largest city) that the council-owned LATE responsible for water and waste water services was paying insufficient regard to the council's social objectives in respect of pricing and of the way in which it dealt with non-payments by domestic consumers. The public perception, supported by statements from some councillors, was that the council was powerless to require the directors of its LATE to take social considerations into account. As the situation was presented publicly, the LATE was required to operate as a successful business and therefore was unable to respect other objectives.

The public perception happened to be incorrectly informed. There were in fact means available to the council that could have dealt with the situation. As an example, it could have contracted with the LATE to "purchase" the social outcomes it required, funding the cost out of its own earnings from the LATE. It could have required the directors of the LATE to include in the company's statement of corporate intent (a document which is prepared by the directors for acceptance by its council shareholders) pricing principles which made special provision for low income households, domestic consumers or whatever category the council wished to protect, while still ensuring that overall the LATE met its target rate-of-return.

The basic problem appears to have been the council's lack of understanding of the measures available. The best response for the government would have been to promulgate a "good practice" guide on options available to local governments for aligning the activities of their LATEs with their council's social objectives. This possibility was pointed out to the Minister of Local Government. Her response was to the effect that, if councils did not understand how to manage their relationships with LATEs, then clearly it was necessary to change the law.

The legislation introduced to parliament was significantly flawed. It showed a lack of understanding of the complexity of some LATE structures and of the processes that actually apply to the governance of LATEs. As one example, several substantial LATEs are actually holding companies with majority interests in listed public companies, including two of the country's largest ports (the Port of Tauranga Ltd and the Lyttleton Port Company Ltd) and one of its larger electricity lines businesses (PowerCo Ltd). In this situation, the risk is that any local government attempt to impose social objectives on directors of a holding company LATE could lead to a breakdown in that LATE's relationships with its publicly-listed subsidiary.

This development highlights two matters of immediate significance. One is the difficulty a government can face when dealing with complex situations outside the experience and practical knowledge of its ministers and/or the officials who advise them. The other is that a shift away from the arms-length basis for SOEs and LATEs under which directors are to reconcile commercial disciplines and social objectives needs to be the subject of explicit arrangements, including the negotiated "purchase" of any non-commercial activity.

Some Lessons and Observations

Before the 1999 election, the then government's relationship with SOEs and other government-owned companies was based on the need for these enterprises to operate as successful businesses in their designated areas of activity and, where appropriate, to be ready for privatisation by way of divestment. Now, the present government rejects the idea of privatisation in favour of continued state ownership, and does not expect or require the directors of SOEs and other government companies to run their businesses with the principal aim of enhancing shareholder wealth.

At the operational level, this change in policy has not been articulated in a clear and consistent way to provide guidance across the public enterprise sector. Rather, it is emerging on a case-by-case basis as ministers address individual policy priorities or respond to particular initiatives and requirements.

Clearly, there is no longer a commitment to using the company form of public enterprise as a basis of separating policy and operations and, thus, as a means of freeing departments from the performance of commercial or quasi-commercial activities. Accordingly, it is likely that the next few years will see more instances of the separated activities being brought back into a departmental or statutory corporation structure - as with, for example, the effective re-absorption of Housing New Zealand Ltd into the Housing New Zealand Corporation (which is a statutory body).

The greatest immediate risk to the New Zealand taxpayer comes from the change in government policy towards investment in SOEs and, in turn, the investment by SOEs in new business ventures. The previous government's strong resistance to further investment in SOEs, or to the diversification of their businesses, may on occasions have lost the taxpayer a potentially profitable business opportunity. The present government's policy, at least as it appears to be operated, carries with it the reverse risk, that the taxpayer may lose substantially through ill-considered investments. Here the question is one of ensuring that there is a robust decision framework in place. Specifically, it seems inappropriate that the government's principal source of advice on the merits of a new business proposal put forward by an SOE should be the board and management of that SOE itself. Implicit in the SOE model is the desirability of replicating, as far as possible, private sector practices. In the private sector, any significant investment decision requiring substantial shareholder capital would be closely reviewed by advisers independent from the company itself - for example, analysts working for, or on behalf of, major institutional shareholders. They might not necessarily get it right, but they would bring an independent eye, and the mere fact of their scrutiny would encourage the company to do its homework thoroughly.

A possible public sector equivalent would be to provide for scrutiny by independent and experienced private sector advisers with no direct relationship with the SOE concerned. The advisers would be appointed to report to the government on the merits of the SOE's proposal (whatever its likely political significance), perhaps with a requirement that, if the government chooses not to follow their advice, it is required to table a statement in parliament setting out its reasons for declining to do so. But even this approach may have its faults, possibly including an incentive for advisers to offer the advice they believe the government may wish to hear in order to protect or secure future government business.

The more interesting issue from the experience of the last two years is why a policy framework that had seemed to be robust should start to break down so quickly. A significant answer to this lies in the criticism, cited above from the Labour party's election policy in respect of the previous government's health reforms, that "the only accountability measures which are regularly reported on or monitored relate to financial rather than health service quality indicators". This criticism was factually correct. The previous government had seen the primary objective of public enterprise reform as being to improve economic efficiency, so it developed sophisticated tools for monitoring not just financial performance in terms of generally accepted accounting principles but also economic performance using a modified economic value-added model.

That approach to performance assessment failed to recognise that there are very few public enterprises for which the primary government interest, or at least the primary interest of the citizens on whose behalf the government acts, is profitability and shareholder value. Instead, the interest is more typically concerned with the nature of the service: can people get hospital treatment when they need or want it; is the electricity supply reliable and at a low cost; is the government's housing provider meeting the needs of low income-earners; and so on?

In late 1999, the government's public enterprise monitoring and advisory body - the Crown Company Monitoring Advisory Unit (CCMAU) - started work on developing non-financial monitoring systems, recognising the broader public interest in the performance of SOEs and other government companies. It began with health and hospital services, utilising the balanced scorecard approach to performance evaluation (CCMAU, 1999). The then head of CCMAU saw the use of an expanded monitoring approach to be a means of capturing an important dimension in the operation of government companies, namely their effectiveness in terms of delivering on the policy objectives of government ownership and on public attitudes towards them. Surprisingly, with the change of government, this work was put to one side.

There is little evidence that public attitudes in New Zealand have ever been strongly supportive of corporatisation or privatisation. Where specific cases have been tested, public opposition has normally been quite strong. Thus, there was definite opposition to the idea of privatising TVNZ, even though the media debate has highlighted the loss of value to the government as a result of technological change. Also, a proposal in 1992 to privatise the Ports of Auckland (the country's major sea port), a proposal which was required to go to public consultation, met with overwhelming public opposition.[7]

None of these ideas or responses necessarily suggests that profitability is an inappropriate objective for public enterprises or that privatisation does not have a place. Rather, they indicate that a government wishing to ensure that a strong public enterprise or privatisation policy can persist should pay at least as much attention to ensuring the effectiveness and public legitimacy of the activities of the enterprises concerned as it does to whether they report a profit.

Concluding Thoughts

The public enterprise changes considered in this discussion can each be seen as an ad hoc approach to implementing government policy in a particular area of activity---for example, the proposed establishment of a "peoples bank" to compensate for a presumed market failure in the provision of services to low income and/or rural New Zealanders, and the restoration of a classic public broadcasting role for the publicly-owned television broadcaster. Taken together, though, a different explanation may have some creditability. This is that the basic assumption underlying New Zealand's SOE model may itself be flawed.

SOEs (and to a lesser extent crown-owned companies), as well as LATEs, were intended to function in compliance with the normal commercial and legal disciplines which apply to all companies registered under the Companies Act, but with additional requirements concerning their operation, control and accountability being specified in complementary legislation, most notably the SOE Act and the Local Government Act, respectively. As part of this framework, the presumption was that any non-commercial objectives of the owner (the national or local government) would be determined by that owner, but that the means of pursuing those objectives would then be negotiated with directors on an arms-length commercial basis to include appropriate payment.

The model overall appears to have been at its most successful for companies where the case for public ownership had been weakest---that is, companies operating in competitive input and output markets where any public policy considerations are best dealt with by general regulation rather than through ownership, and where the owner was unlikely to have any non-commercial objectives it wished to pursue through the company. The situation is clearly different for those companies where the case for public ownership is strong in terms of the policy objectives of the government of the day. Here it seems that the arms-length model for pursuing social objectives is simply not acceptable. It may be, as with housing services, quite logical for a minister to believe a company is an inappropriate vehicle for delivering a social service. It may also be that the government wants a more hands-on approach to the delivery of particular types of services because of their importance to its social agenda, as is presently the case with banking and public broadcasting.

It seems clear that the present government is not prepared to resolve any of these matters within the framework established by the previous government. One possible explanation is that it is unwillingness to confront directly the full costs of pursuing social objectives - for example, public estimates of the impact on TVNZ of its new public broadcasting requirements range as high as NZ$100 million per year, though the Minister of Broadcasting has repeatedly denied that the cost will be anything like this. Another possible explanation, that goes to the heart of the model itself, is an unwillingness to rely on directors, who are selected on the basis of commercial skills and tasked in commercial terms, to deliver on social objectives even within the bounds of a contract that is entered into specifically for that purpose.

These considerations all suggest that New Zealand may be witnessing the breakdown of its SOE model as earlier conceived. This is fundamentally a result of a conflict between what is required to realise political/policy objectives and what is needed to manage a commercial business in a complex and changing environment.

Notes

1. Detailed information on the extent of the New Zealand privatisation experience is reported on the website of the Treasury, 1999: www.treasury.govt.nz

2. These boards will be of interest to students of public sector reform for more reasons than just the rejection of the company form. They will be responsible not just for running public hospitals but also for purchasing all public health services in their area, creating some potentially difficult conflicts between their purchase interest and their ownership interest in the hospital service.

3. This led the government's principal adviser on SOEs, the Crown Company Monitoring Advisory Unit, to investigate the introduction of the equivalent of the UK's Independent Commissioner for Public Appointments, whose responsibility is to oversee the integrity of such an appointment process.

4. The situation is extremely complex. With hindsight it seems that New Zealand Post took on a task that was far more difficult, because of circumstances within the South African Postal Service, than appeared at the time it tendered for the contract.

5. As part of the change, the government will no longer be setting the same aggressive profit targets as TVNZ has previously had.

6. This could have been via a direct payment from the government to TVNZ, perhaps by TVNZ's obtaining a much larger share of the funding available through New Zealand On Air, which is the government's present instrument for providing support to radio and television broadcasting, including independent program making.

7. The owner of Ports of Auckland, the Auckland Regional Services Trust, was legally a local authority and thereby was required to consult the public on the disposal of significant assets.

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