Options for reforming state owned enterprises

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Colombo Club, 22 July 2016

Our problems . . .

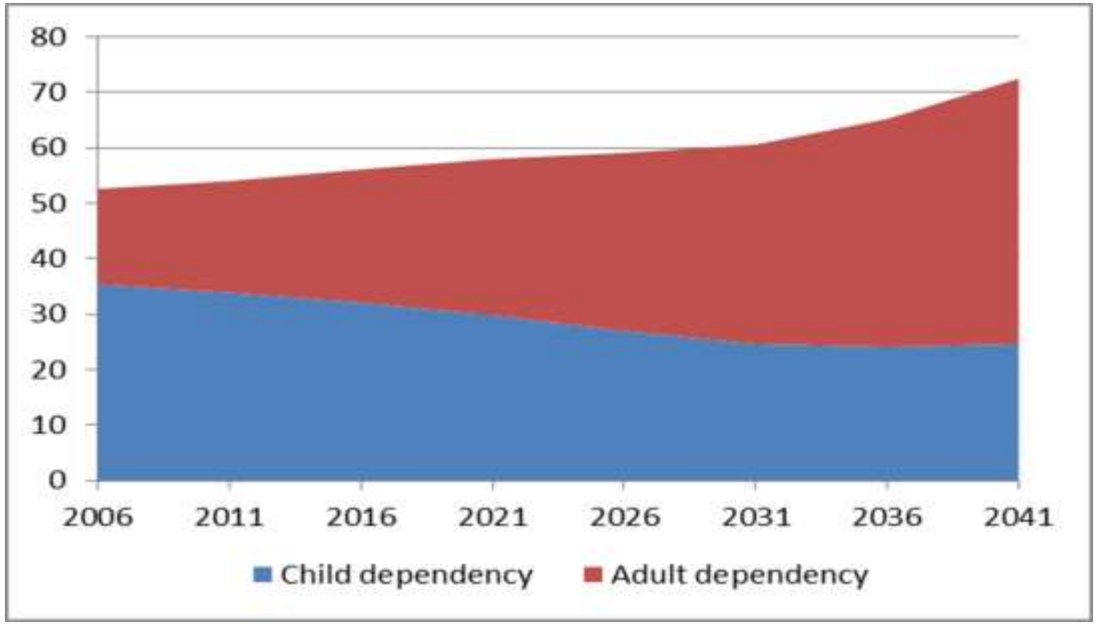
- Not enough exports . . . .
- Young people wanting jobs that the economy is not producing . . .
- Getting old before getting rich . . . .
- Profligate government lacking resources to address our problems . . .

Focus of this talk

- Not enough exports . . . .
- Young people wanting jobs that the economy is not producing . . .
- Getting old before getting rich . . . .
- Profligate government lacking resources to address our problems . . .

Growing old before getting rich . . .

- Increasing number of elderly persons (including many who are disabled) will have to be supported by a decreasing working population
- A publicly funded safety net is essential
  - To take care of the elderly and the sick, but also
  - To enable those in the productive age groups to innovate and take risks
- A risk-averse nation cannot prosper in today's fast-changing global economy as shown by
  - Nokia, Yahoo, Kodak, Borders Books . . .

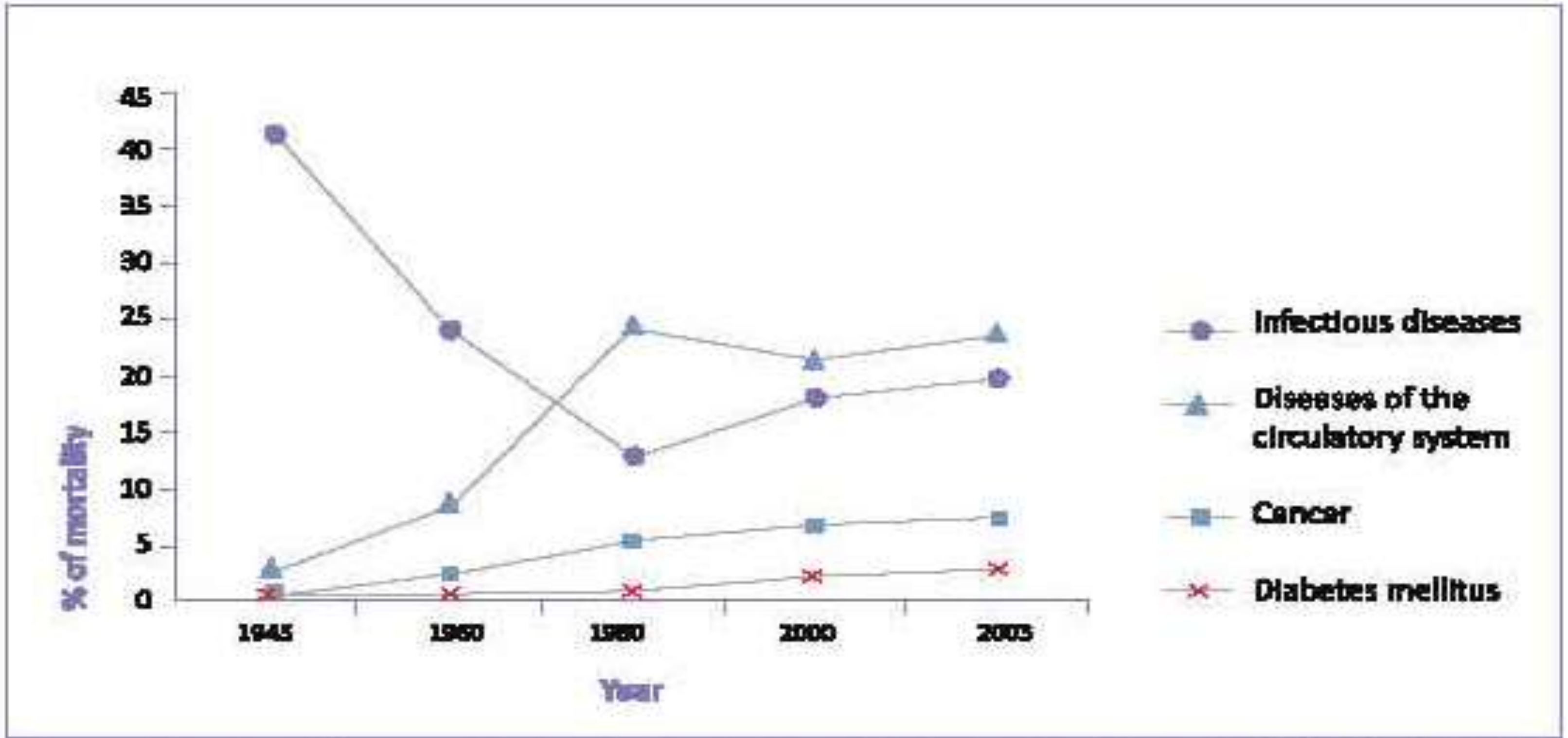


Source: Dr W. Indralal de Silva

A 74-year-old elderly father who was abandoned in a bus stand
Weeraketiya pleads to be taken to an elders' home.

After his wife died 33 years ago he had brought up their only da
However, after getting married this daughter had sold their pro
and left him to fend for himself.

Living longer, but not well . . .



Source: Analysis by authors using data from the Registrar General's Department for 2000 and 2003; UN ESCAP (1976); Department of Census and Statistics (1987)

Source: World Bank (2010). Prevention and control of selected non-communicable diseases in Sri Lanka

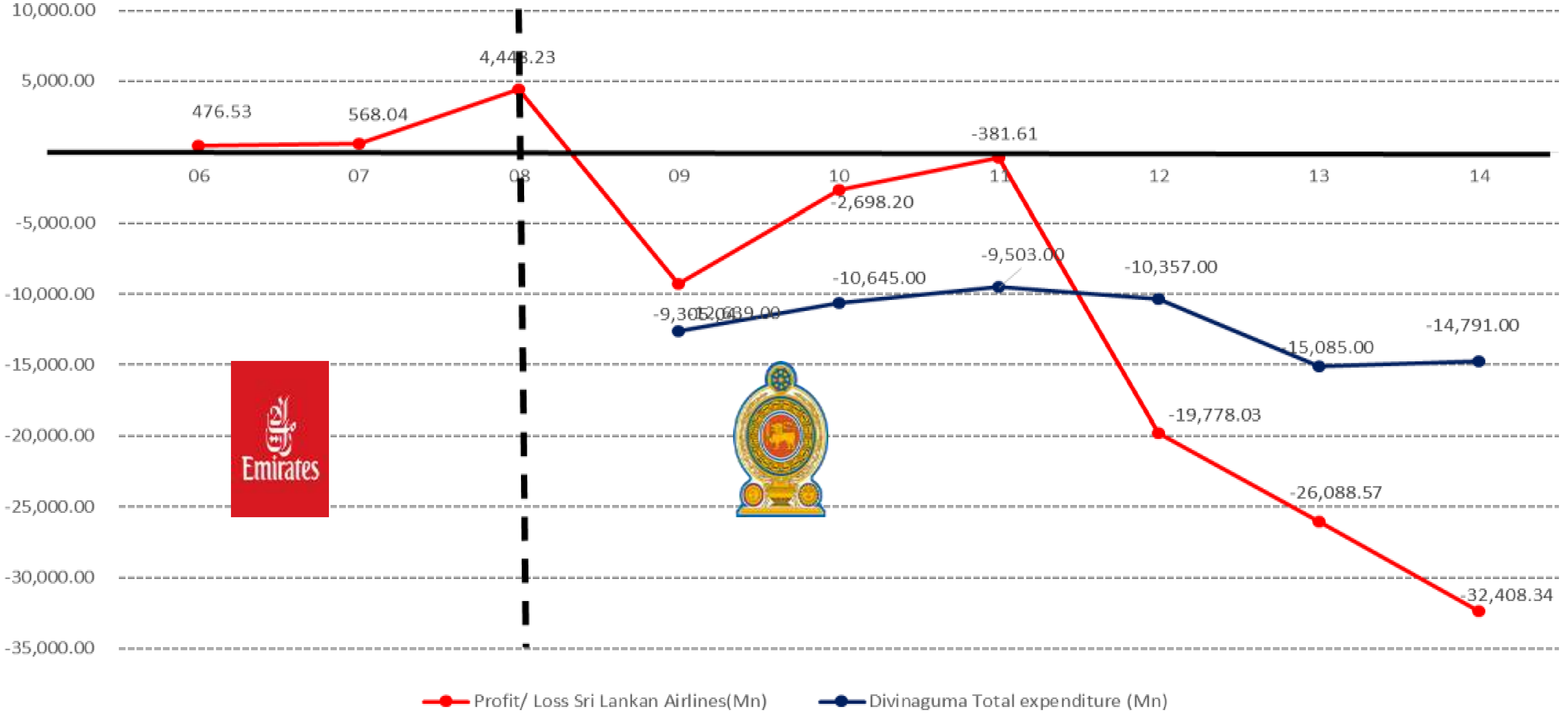
Profligate government lacking resources to address our problems

Name of the state own enterprise	Ceylon Petroleum Corporation	Ceylon Electricity Board	Sri Lankan Airlines	Sri Lanka Transport Board	Mihin Air Ltd	Σ 5 out of 55 SOE's
Cumulative losses 2006- 2015	LKR 244 Billion	LKR 172 Billion	LKR 112 Billion	LKR 61 Billion	LKR 16 Billion	**605 Billion**
As a Percentage of cumulative losses*	38%	27%	18%	09%	03%	**95%**

605 Billion = 18% of 2015 GDP in Sri Lanka = 81% of the current budget deficit in Sri Lanka

[*Cumulative losses of 55 strategically important SOE's as per treasury]

Sri Lankan Airlines - Profit/ Loss vs. Divinaguma Expenditure (LKR Mn)



Policy windows open when Iron Triangles get destabilized, but don’t remain open for too long*

- *You never let a serious crisis go to waste. And what I mean by that it's an opportunity to do things you think you could not do before.*

  Rahm Emanuel, 2009

- Asian Financial Crisis → IMF intervention → Indonesia’s reforms
- Present economic crisis may cause government to change how it manages SOEs; it has the mandate from 2015 elections
- Third nationwide blackout has put those safeguarding CEB status quo on backfoot, but . . .

- With apologies for mixed metaphors, but these are serious policy-studies terms: Kingdon, J.W. (1984), *Agendas, alternatives and public policy*; Heclo, Hugh (1978). “Issue networks and the executive establishment,” in *The New American Political System*, ed. Anthony King.

First Best: Competition wherever possible, regulation where necessary . . .

- For effective competition, state cannot own some of the competitors because it has power to tilt the playing field, even if in unregulated industries (e.g., preferential access to credit; taxation)
- Regulation only necessary for infrastructure industries or those with serious information problems
  - Regulation is only partially effective with state ownership
    - What is the point in fining a state-owned company?
    - How practical is the cancellation of a license?

- → First-best solution includes privatization

What is the second-best solution?

Originally proposed by Ven. Athuraliye Ratana, M.P.; included in 2015 January Common Candidate's Manifesto; also in UNP's 2015 August Manifesto

- The Government is the largest owner of business institutions. The ownership is held in trust for the people. Unfortunately these businesses have not been properly managed for the last 50 years. Therefore those institutions have incurred severe losses. As a remedial measure, all public enterprises will be placed under a Public Business Enterprises Holding Corporation Ltd. Trustees of the corporation will by law be appointed through a scheme based on consensus reached by the political parties and civil society. Further, laws will be introduced to regulate this institution on the same principles as a limited liabilities company.

Temasek model, as explicated before a simplistic understanding got entrenched (*FT, 29 January 2015*)

- Temasek owns SOEs that can be treated as normal business enterprises (not those that have other objectives such as the provision of housing or welfare) and can be subject to normal regulatory oversight. **The companies make commercial decisions and do not supply services below cost**.
- The SOEs are **managed by professionals whose only mandate is to run the companies efficiently and produce adequate profits for the owner**, Temasek Holdings. Depending on how they do on the defined performance indicators, they hold their positions. The assistance they provided to the ruling party or who they are related to by blood or which school they attended are not criteria for selection.
- How are the performance indicators set? No one can be asked to produce ever increasing amounts of profit, especially under competitive conditions. Without doubt, the ups and downs of the economy as whole will also impact return on investment.
- **The solution is to list the companies on the stock market**. So the performance of the Board members of companies such as Singapore Airlines that face competition are judged by metrics that include share price. **If the holding company determines that the investment is yielding inadequate returns, it can sell down its stake, in addition to getting rid of the directors.**

Good solution, but with some problems . . .

- **How is performance of the directors of Temasek Holdings assessed?** They are the final decision makers regarding how much equity is held in the various government-owned companies (they also hold equity in other companies such as Standard and Chartered (18%) and Bharti Airtel (3%). What is their accountability with regard to the investments and appointment and oversight of directors?
- Temasek **performance is judged in relation to benchmarks connected to the performance of its companies**.
- Yet, one cannot have purely objective criteria. However well the company is managed, there will be years when it will perform badly. That is just the way it is when one invests money. **In any democracy, sovereign wealth funds will come under pressure when times are tough.**
- For that, you have the final safeguard. Since 2002, **Temasek's CEO has been Ho Ching, who just happens to be the spouse of Lee Hsien Loong, the current Prime Minister and a member of the first family**. It also has a strong and empowered Board that includes several truly independent directors, including the former head of the World Bank.

But changing ownership by itself is no panacea

- A private monopoly or duopoly can be as bad as an inefficient government monopoly ➔ competition and regulation where necessary must be introduced
  - Regulation promise that was part of LPG privatization in 1995 was not kept ➔ gave privatization a bad name
- But competition without changes in organizational culture of the former monopolist can cause it to atrophy

➔ Sector reform along with organizational reform are needed

Case of relatively successful telecom industry reform, 1997-2003

Sector performance has improved

- Connectivity: No waiting lists, no petty corruption
- Price: Until tax madness of 2015-16, lowest voice and Internet prices in world
- Quality: Room for improvement, but radically better than in monopoly era
- Choice: Improved

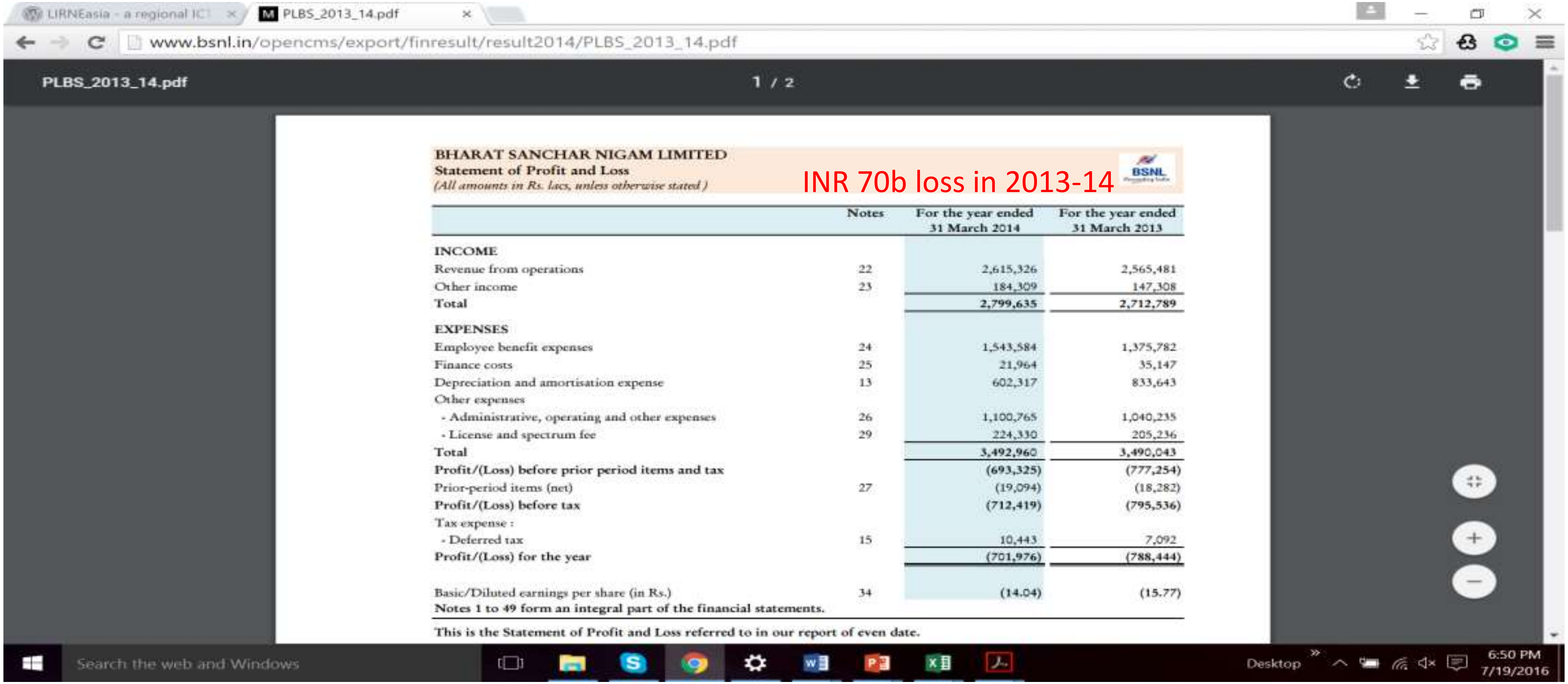
- In addition to contributing to lowering of transaction costs across the economy, telecom sector provided LKR 31 billion from telecom levy alone in 2014 (almost enough to meet SriLankan Airlines losses that year)

~50% government-owned SLT Group is not a burden on taxpayer (LKR 6b< to govt in 2015)

	2015	%	2014	%
Value added				
Revenue	68,022		65,040	
Other income	1,124		2,751	
	69,146		67,791	
Goods and services purchased from other sources	(28,579)		(27,997)	
Value creation	40,567		39,794	
Distribution of value added				
To employees				
– Salaries ,wages and other benefits	15,577	38.40	14,150	35.56
To providers of capital				
– Dividend to shareholders	1,606	3.96	1,606	4.04
To Government				
– Taxes and regulatory fees	5,649	13.93	6,371	16.01
To lenders				
– Interest and related charges	2,398	5.91	211	0.53
To business expansion and growth				
– Depreciation	13,219	32.59	13,061	32.82
– Retained income	2,118	5.22	4,395	11.04

SLT Annual Report 2015

In Bangladesh & India, where market opening was not accompanied by organizational reforms of SOE, they are still gobbling taxpayer money



BHARAT SANCHAR NIGAM LIMITED
Statement of Profit and Loss
(All amounts in Rs. lacs, unless otherwise stated)

	Notes	For the year ended 31 March 2014	For the year ended 31 March 2013
INCOME			
Revenue from operations	22	2,615,326	2,565,481
Other income	23	184,309	147,308
Total		**2,799,635**	**2,712,789**
EXPENSES			
Employee benefit expenses	24	1,543,584	1,375,782
Finance costs	25	21,964	35,147
Depreciation and amortisation expense	13	602,317	833,643
Other expenses			
- Administrative, operating and other expenses	26	1,100,765	1,040,235
- License and spectrum fee	29	224,330	205,236
Total		**3,492,960**	**3,490,043**
Profit/(Loss) before prior period items and tax		**(693,325)**	**(777,254)**
Prior-period items (net)	27	(19,094)	(18,282)
Profit/(Loss) before tax		**(712,419)**	**(795,536)**
Tax expense :			
- Deferred tax	15	10,443	7,092
Profit/(Loss) for the year		**(701,976)**	**(788,444)**
Basic/Diluted earnings per share (in Rs.)	34	(14.04)	(15.77)

Notes 1 to 49 form an integral part of the financial statements.

This is the Statement of Profit and Loss referred to in our report of even date.

Port: Our example of competition without reforming SOE

Government-owned terminals not doing well

- JCT has most capacity, but is lowest in capacity utilization
- Raking in money for nothing from 15% shares in competing terminals
- Loan liabilities amount to 69% of assets

- May do better as pure landlord in keeping Colombo competitive
  - Partially privatize JCT as well
  - Give all suppliers pricing flexibility
  - Set in place competition and safety regulation only

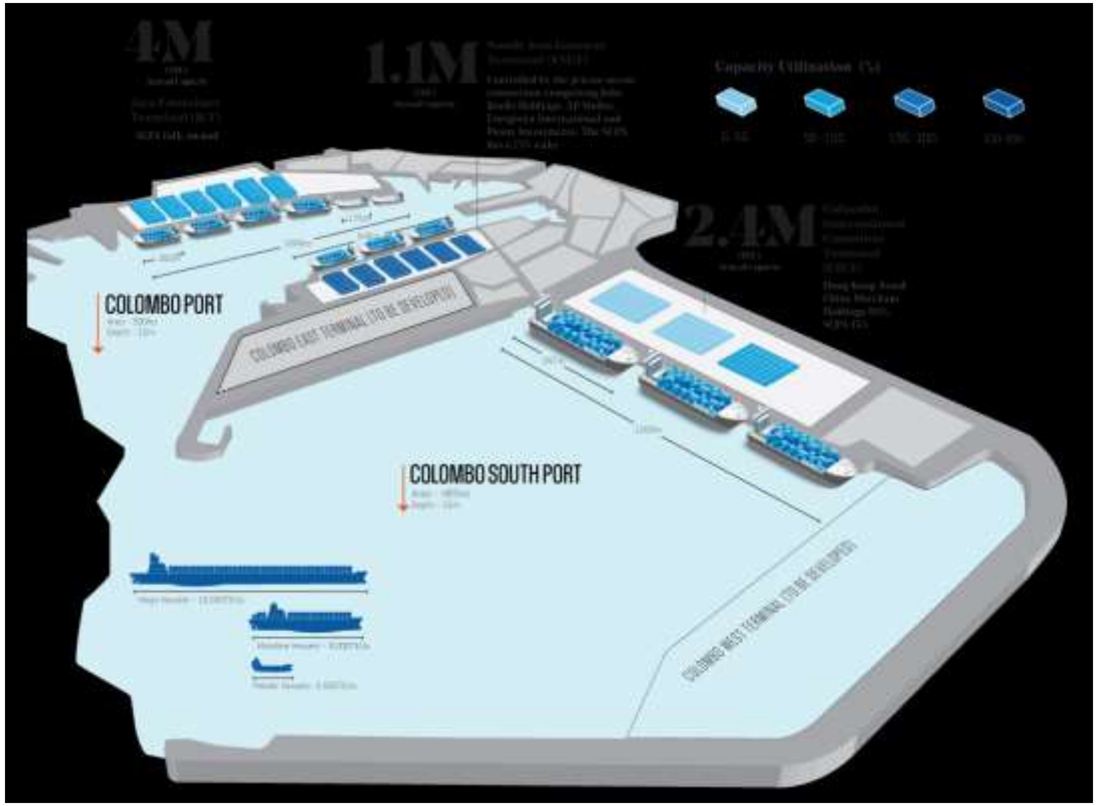
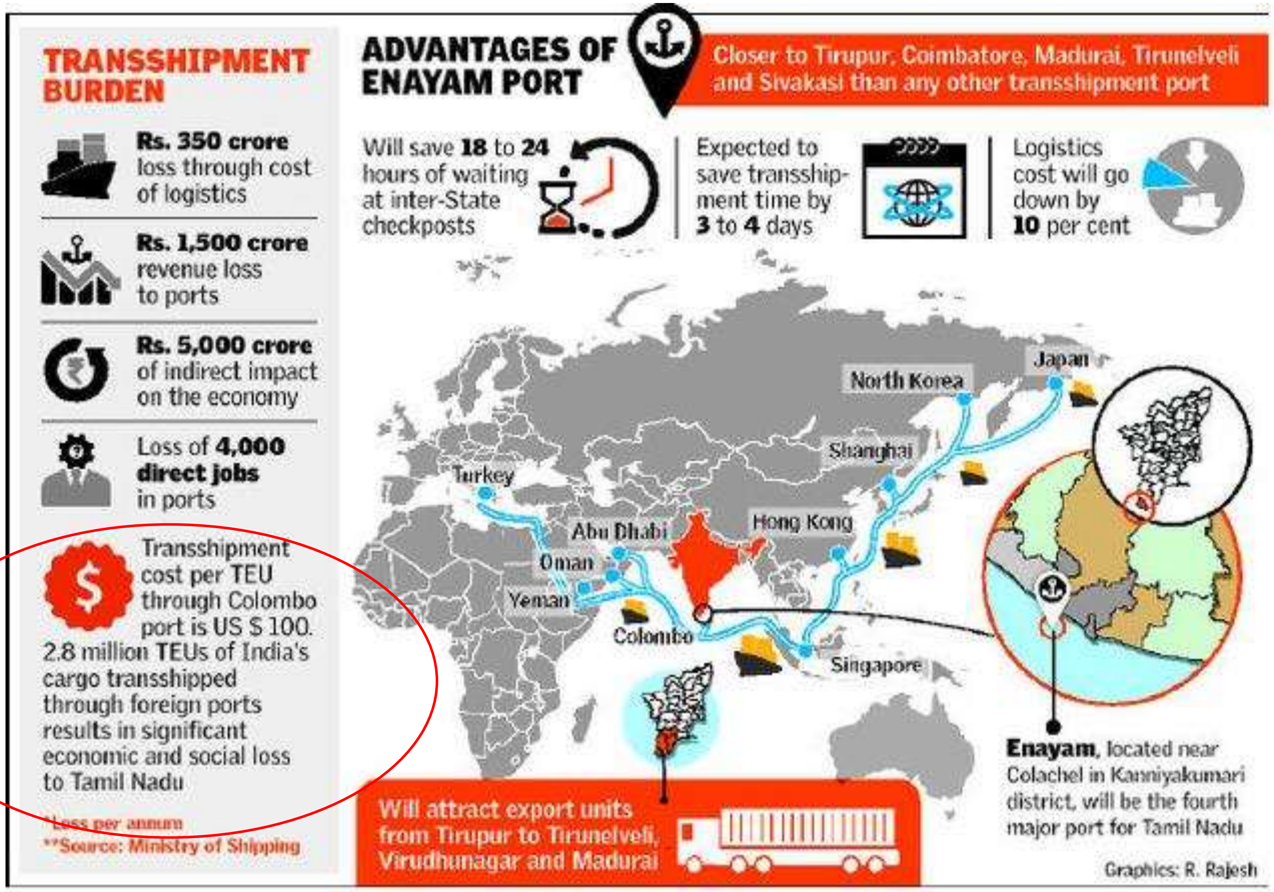


Image and data from Echelon

India is actively seeking to displace Port of Colombo



http://www.thehindu.com/news/cities/Madurai/enayam-a-port-anchored-in-hope/article8863800.ece

If we can reform sectors that are ill-served by inefficient SOEs . . .

- Economy as a whole will benefit (as with telecom) → higher growth will generate more tax revenues (as with telecom)
- Billions of budget support wasted on money-losing SOEs could be spent on better things
- Non-tax revenues for government will increase from PPPs

→ Government will have the money needed to solve the urgent problems we face, such as that of getting old before getting rich