

Privatisation



The subject of privatisation has come up recently in the context of the Water Supplies and Drainage Services Departments and sparked some discussion about its merits and demerits. This month J A McInnis looks at the background of the controversy, some likely subjects for privatisation, and the case for it in more general terms.

Background

Privatisation is now a global phenomenon. The changes have been driven by a combination of ideological and economic factors. The most prominent of these factors is the decline of socialist economic theories and the inability of countries to finance necessary infrastructure development out of public funds. Privatisation in Hong Kong has a very long history relative to most other jurisdictions. While the subject of privatisation may be thought by many to be a recent initiative in fact, if one looks further back in time and adopts a broad perspective on the subject, it can be seen to date to the earliest local Build Operate Transfer (BOT) projects. Hong Kong has led in many ways in the provision of privatised infrastructure dating as far back as 1969 and now has almost unparalleled experience in the region on which it can capitalise. In fact the relative success of the Airport Core Projects (ACP), notwithstanding the problems in the initial opening of Chek Lap Kok, positions Hong Kong to play a leading role in the packaging of such projects for other jurisdictions. It is interesting that the ACP projects are still viewed as models by many around the world and among the best examples of privatisation (once again notwithstanding the recent inquiries). The experience Hong Kong has in this area, coupled with the government's plan to seek to continue leading in the regional export of services, will mean that these and other such privatisations are portrayed in a favourable light in the future.

Benefits of Privatisation

Privatisation can be defined in a variety of ways. Typically one will think of the sale of a public asset to the private sector. However, in practice today, privatisation can take a variety of forms. Thus while it could include simply a sale of a public asset to the private sector it might equally involve a private finance initiative, contracting out or even operating through the trading fund.

Privatisations are generally held out as comprising numerous benefits in the Hong Kong context, some of which would include:

- * Further development of the financial, capital and bond markets;
- * Limiting increases in, or reducing the size of, the public sector;
- * Relieving the government of the financial and administrative burden in relation to proposed or existing works and/or delivery of services;
- * Accelerating economic growth;
- * Increasing efficiency in, and improving, productivity;

The past experience of Hong Kong in the delivery of successful privatised infrastructure projects has also created an environment that supports this model. In short there has been a demonstrated commitment to making privatisation work locally. Several additional factors that lend additional support to privatisation may be noted.

- * First of all, the trend is now global. It marks a return, full circle, to the original forms of construction and operation of road, rail and canal infrastructure developments as well as the first utilities in 19th century Europe;
- * Secondly, Hong Kong has no foreign exchange restrictions and few restrictions on foreign participation in privatisation projects. This increases the attractiveness of holding equity stakes and remitting profit shares elsewhere when desirable;
- * Current tax rates are low relative to other jurisdictions and this provides an incentive to participate relative to other investment opportunities;
- * Most projects considered for privatisation would be revenue and profit generating.

Some arguments to the contrary may also be noted including:

- * That the benefits of privatisation in a given context, e.g. the two departments in question, have not been established;
- * The separation of ownership of privatised assets could lead to the reduction of maintenance obligations in respect of them to achieve cost-savings by the owner/operators;
- * Very often financial subsidies must continue to be paid in respect of privatised assets to maintain their viability.

Recent Privatisations

Government Property Agency:

Outside of the developments already referred to, a number of low profile privatisations have taken place recently that have proved relatively successful. It is suggested here that these examples provide markers for future government privatisation initiatives. One of the best examples is the Government Property Agency (GPA).

In the past the GPA has held a brief for the management of all government accommodation save urban and regional council, hospital and housing authority properties. In April 1994 a move began to first privatise the management of government quarters operated by the GPA. Since that time the GPA has argued that services have been improved and economies or annual savings amounting to \$24 million realised. Building upon the success of these moves the GPA is currently privatising the management of major government joint use office buildings. The projected savings on an annual basis at this time are estimated to be some \$10 million.

The GPA has also moved during the last two years both to sell and lease surplus to requirements non-departmental quarters to the private sector thereby generating both additional income and profit. These examples are at the centre of the GPA's move to privatise but it may also be remarked that they are in addition to the current commercial letting services the GPA undertakes on its own behalf.

Hong Kong Telecom:

On February 5th 1998, under the World Trade Organisations world telecoms agreements, signatories agreed to open up their telecoms markets. Parallel to this development, separate agreements were signed by many other countries pledging to open up their technology sectors to create a world wide market in information technology (IT). In addition the digitalisation of information has blurred the traditional dividing lines between broadcasting, telecommunications and publishing. Thus, it is no coincidence that the Chief Executive in his recent Policy Address gave so much attention to the subject of IT. There has been some occasional criticism of this aspect of the Policy Address and commentators have wondered aloud whether there is any point in pursuing an active IT policy when Singapore and Taiwan appear to have such a lead. However, the response must be that these wider developments behove Hong Kong to participate now in moving forward, or be forever left behind. It was these developments in large measure that prompted the Hong Kong government to move forward the end of Hong Kong Telecom's monopoly on IDD calls. The monopoly was originally intended to last until 2006 but will now soon expire. Under the Hong Kong Telecoms deal as from January 1, 1999 other telecom providers will be able to lease capacity from Hong Kong Telecom and resell it to their own subscribers. This introduces some measure of competition to the market.

At present, direct competition is anticipated to come about as

other providers become able to build their own infrastructure and then compete directly with Hong Kong Telecom. It is because of the early termination of Hong Kong Telecom's monopoly that we have seen a host of new service providers entering the market. This is privatisation in the sense of what has been a monopoly utility service. By opening the sector to other providers some of the benefits associated with a more typical move from public to private sector still accrue. Many of the telecoms companies that are expected to compete in this way will have once been nationalised utilities in their own home jurisdictions prior to their privatisations. The benefits of these moves are anticipated to be lower prices, better quality service and more diverse and customised services for consumers.

Proposed Privatisations

Water Supplies and Drainage Services Departments:

In late November some of the first press reports of possible privatisations in the Water Supplies and Drainage Services Departments were noted, arising from debate in a Legislative Council meeting. The initial press reports focused upon concerns of union leaders who feared job losses as well as lower staff morale and performance. One politician wondered how water quality, supply and existing price levels would be maintained

In reply to these early concerns, Secretary for the Treasury, Denise Yue Chung-ye, said in late November that there was no timetable for the privatisations and set out seven questions which she said had to be asked in considering whether to go ahead with a privatisation:

- * Did the assets belong in the public sector?
- * Is there sufficient demand for the asset?
- * Would privatisation generate economic and other benefits for Hong Kong?
- * Would it result in improvements in areas such as operating standards, efficiency, safety and service quality?
- * Could an acceptable balance be struck between the interests of potential investors and those of customers?
- * What would be the implications for staff and how could it be addressed responsibly?
- * What would be the financial benefits for the government?

With the exception of the first two questions, which are ambiguous, these are the right sort of questions that should be asked prior to embarking upon any privatisation. Caution has also been expressed in recent editorials. In particular it has been pointed out that Hong Kong in general has no immediate need for cash. This contrasts with other jurisdictions which have, and continue to run, large annual budget deficits. It also places Hong Kong in an almost unique position. That is, Hong Kong can consider privatisations on their merits alone. In terms of Denise Yue's seven questions above, then it means focusing upon 3, 4, 5, and 6 in coming to a decision.

Other Potential Privatisation Subjects

Several possible subjects of privatisation have already been suggested. These now include the Kowloon-Canton Railway Corporation, The Mass Transit Railway Corporation, The Hong Kong and Western Tunnels Companies, and the Airport Authority. While these are candidates for privatisation it is suggested here that their current operation along 'prudent commercial lines', which are revenue and profit generating, removes at least some of the reasons why privatisation is normally pursued. While the government has varying interests in these subjects it is remote in all of them save the Airport Authority (AA). The successful privatisation of the British Airport Authority is a successful precedent though, and could serve as a model if it were expected that the AA would be likely to become involved in operating other airports in the region.

Some Final Considerations

Any potential privatisation brings forward a host of considerations. Most importantly there is the question of whether, and, if so what, form of industrial or regulatory regimes would be needed. In the case of the Water Supplies and Drainage Services Departments this would be a major issue. There would also be questions surrounding pricing, and the expected financial and efficiency performance criteria to be used to judge them. Lastly one would need to decide on the precise mode of privatisation and where the balance should be struck between the interests of

consumers and owner/operators. Surprisingly one of the first things that would likely have to be done for both departments would be to improve their existing productivity. Were this not the case, the returns would simply be too low to generate interest in privatising either department. It has already been remarked that operations might not be financially viable if subsidies were not continued. Privatisation of either department would also have to be coupled with changes to the tariff structure as has been done in the case of Hongkong Telecom. However it is unclear whether consumers would be willing to pay the charges associated with new tariff structures. It is estimated that charges would have to at least double to begin to approach their true cost.

In summary, privatisation is likely to continue both in Hong Kong and elsewhere. In some cases privatisations can, and do, add value overall — but we should still be mindful of those that do not. Before privatisations are pursued the benefits should clearly outweigh the risks in the context of our own unique set of circumstances. There are also still lessons to be learned both at home and from abroad in deciding whether and, if so, how such privatisations should be structured to maximise their return — not only to the government and future owner/operators, but society as well. ■AAC

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