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ON PRIVATIZATION

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GIVEN BY HENRIETTA HOLSMAN FORE

Best Available

Thank you, Dr. Butler. It is a pleasure for me to be here today to add my voice of pride for energetic and intellectual leadership provided in the work of Adam Smith Institute.

My husband and I, last night arrived from Lisbon and talk of privatization was in the air, and I am pleased to see Portugal in our program tomorrow. There is the recognition in Lisbon, that privatization is public program, one that attracts interests of voters. They are wrestling with familiar issues: too fast, too slow, which companies, what about housing, pricing, unemployment. Still and all political will is there. It is an immediate reminder we are living through a worldwide economic shift, and that privatization is essential in carrying out that shift. It becomes "popular capitalism" a notion created here in Britain, where large numbers of the populace have a stake in system.

In U.S. Agency for International Development, we have just completed a survey 40 projects. It found that strong and continuing political support was the only consistent factor in determining success. Political factors are so important that

they will determine if privatization can even be tried. If tried...then economic and legal policy reform...assistance with capital markets...and the provision of credit facilities must move ahead concurrently.

Privatization is an idea that is changing the world. The English Philosopher Alfred North Whitehead said. "Ideas won't keep. Something must be done about them. That is certainly true of privatization.

Last weekend my family and I were motoring in Massachusetts and we were caught up in the historical events in Concord and Lexington. In 1776, in America, we were creating a new nation...dedicated to "life, liberty and pursuit of happiness." Ideas that were born in England; and carried out in America, that forever changed western thought about democracy and political freedom.

And, in 1776, in England, another idea was being put forth. An idea so profound and consequential in the course of human events...and to a degree far greater than its drafter could have imagined. I think the Adam Smith Institute proudly follows your namesake for the worldwide impact you have had with your ideas of privatization. But in Adam Smith's wealth of nations - who could have foreseen...that wars and revolutions

would be waged over the thoughts put forth in this writing...that fortunes of individuals...as well as nations...would hang with the success of these thoughts.

So, as we passed through New England, the force of the ideas from 1776 seemed very close. Ideas that wouldn't keep -- America's Declaration of Independence and Adams Smith's The Wealth of Nations -- ultimately became inseparable in their destiny.

For -- though America's Declaration of Independence called for a society dedicated to "Life, Liberty, and the Pursuit of Happiness"...it was Adam Smith and The Wealth of Nations that would explain how such a system worked.

USAID adopted last month new Mission statement which sets as its central role five foreign policy goals.

- (1) supporting free market economies which holds the promise of prosperity;
- (2) supporting the democracies...which holds the promise of representation and participation;

- (3) building of individual well-being offering the tools that countries need to help themselves cure poverty...ignorance...malnutrition and disease...for this holds the promise of self-reliance and dignity;
- (4) helping to solving the global problems that transcend national borders, such as the environment, AIDs, and a humanitarian response to natural disasters...which holds promise for future generations; and
- (5) working with multilateral and multinational forums which hold the promise of global peace and prosperity.

Ultimately...however...the success of the ideas of Thomas Jefferson and Adam Smith remain the hinge upon which the success of individuals and nations alike swing.

The mission of my office...the Bureau for Private Enterprise is to encourage market economies with access by all, and to encourage growth through private enterprise. We could rename it: the Bureau for Adam Smith's ideas.

Without going into too much detail...this bureau is designed to provide expert technical services to client countries for economic development through the private sector.

We offer a range of service...from privatization and policy change...to bank and housing loan portfolio guarantees...specialized services for financial and stock market development for informal economy analysis to microenterprise financial and technical assistance...and a newly established office to encourage trade and investment.

Although we work in all regions of the developing world...we focus on those countries which have demonstrated a commitment to policy reform that encourages private sector-led economic growth.

Of all the reforms needed...privatization has perhaps the greatest impact: it sends a strong message.

It is based on the fact that the private sector is the most appropriate mechanism for creating wealth. A healthy and independent private sector helps lead the way to expanded choice by individuals and strengthening of democratic institutions.

Or...to quote the economist Milton Friedman..."History suggests that capitalism is a necessary condition for political freedom." All of us in this room today are exploring how far capitalism and economic freedoms can and should lead or lag political freedoms.

Hence...A.I.D. continues to pursue its commitment to encouraging a global shift towards privatization and political freedoms.

We are assisted in that pursuit by our world wide privatization center which has garnered five years of invaluable experience in over 70 countries around the world.

We have financed long term privatization advisors in Honduras where we helped the government sell 17 companies worth over \$50 million. We are currently working with the Tunisian government to develop and implement a strategy for divestiture. In fact, we have helped the Tunisians sell more than 19 state companies for a value of over \$60 million. And we are working in Costa Rica.

We are meeting the new challenge of Central Europe and assisting the government of Hungary with a long-term advisor to set up the Hungarian privatization mechanism, the State Property Agency. This case is interesting for other countries seeking to privatize large number of firms in a relatively short period of time, and we are fortunate to have some Hungarian participants here today.

At the same time we are hard at work with our client countries on concrete privatization actions...we are reviewing our lessons learned over the past five years...and expect to make a significant stride forward in our policy by incorporating these lessons.

Without going into all of those lessons -- for I anticipate that Paul Elicker...Executive Director of the Center for Privatization...will elaborate more fully on these topics in his address to you this afternoon -- I do want to briefly mention a few...such as how politically painful privatization can be for fledgling or transitioning democracies. Issues of unemployment and national patrimony, of speed and pricing and thus partisan politics will inevitably arise.

Also...many privatization programs will fail if objectives are no more than a collection of generalized precepts. Successful programs usually have precise...carefully thought out objectives that interlock and support one another.

Policy reform or privatization, either could come first but...it is best if they proceed simultaneously. For they tend to stimulate each other.

And lastly any privatization program needs follow up with access to management services, technology and investment. We can no longer feel that once the privatization sales are completed that the program is complete. It is incumbent on us that the program is a success only if it is contributing to a private economy, not that the program is a success because the transaction was placed in the markets. These are a few of the lessons we are learning, and they form the basis for the three objectives of our privatization approach.

These three objectives are:

- to integrate the developing nations into the world economy;
- to foster growth with equity through competition, and
- third...to support democracies through increased voice and choice.

These objectives are -- in many ways -- in reaction to four global trends.

First...we are witnessing the greatest urban migration in the world's history. Global population is pressing at eight

billion people by the year 2000. In 1950 there were only 10 cities of 5 million or more people. In ten short years -- there will be 48 cities of 5 million or more...and 37 of these cities will be in developing nations.

Along with this rocketing population growth and rapid urbanization will come a flood of demands for social services -- such as sanitation...medical and housing -- as well as education and vocational training. The privatization of social services will be the best hope of meeting the demands of this urban migration.

At the same time...however --- a second trend that exacerbates the problem for all of us -- it is the scarcity of capital in the developing world in comparison to its needs. As world credit markets contract in the face of increasingly risky and problematic developing world investment environments.

Third...technology development and transfer. I am concerned that the industrialized countries are innovating technologies at an increasing rate and technology gap between the developing and developed countries is widening. And contributing to this the developing countries needs to insure the productive use of labor of burgeoning populations. This remains a critical -- and constantly growing -- factor for developing nations.

The fourth trend and very important...it is the decline of state control. As stagnant centrally-planned economies continue to fail...there is increased opportunity for western-style economic freedoms...world peace, and expanded trade...and this is the world trend that is really helping all of us working in privatizations.

Yet...with that opportunity...comes heightened pressure to deliver the services necessary to implement free market economies...and see them through to success.

Let me turn the very interesting notion of competition. As a person who came from business, I know first-hand how difficult a concept it is to put into practice. As a consumer competition and its beneficial effect on increasing variety, raising quality and lowering costs was very clear to me. The legal introduction of Japanese cars into our American economy did increase choice and quality and lowered costs. I like having 20 different breakfast cereals and 20 different athletic shoes to choose among. But as a business person, I spent most of my waking hours trying to beat out, eliminate or exclude competition. Individuals may espouse the virtues of competition, but most companies are dreaming of, and planning for monopoly. Why then, should we be discouraged when developing country businesses react the same as our

industrialized country businesses? The benefits of competition are overwhelming: widespread ownership of resources, and the growth of jobs and skills. Thus, in my Bureau we have set a goal for ourselves to press forward on creating regulatory and policy climates to encourage competition. As an encouragement, we are looking at ways to break down many of the large state owned enterprises many conglomerates into smaller, more manageable businesses in which these can allow greater local participation in management and financing and ownership as well as greater chance for success.

What does the future hold for our privatization effort? Certainly...old formulas and traditional methods of assistance simply won't work. Let me suggest a transaction we might consider to cover environmental costs. Let us take an example from Eastern Europe. Let us say we have a large SOE, a heavy polluter that is to be privatized. Couldn't we consider an small additional transaction fee to be set aside as a "clean up account". If 2% were charged, 1% from buyer, 1% from seller to cover air, water and land clean up and the ongoing filtration of effluents for that company. The cleanup account would be spent within 2 or 3 years. If we can cover environmental costs at the time of the transactions, not later, we will give benefits to the divesting government and country, the employees, the neighbors and the new buyer.

Let me address several areas where we hope for future collaboration with you, our colleagues.

Let us all try to create good climates for commercial businesses from customs regulations to tax laws. A good business climate is good for indigenous and foreign investors.

Let us promote regional trade and investment which will in turn encourage integration into the global marketplace.

Let us all try to work on simplifying the legal...fiscal...and regulatory procedures that often suffocate the entrepreneurs and any desire for growth, capital reinvestment, or larger labor forces.

Let us try to break down very large state-owned enterprises into smaller units to assist in restructuring and divestment.

Let us offer follow-on ...yes...follow-on services after the privatization has taken effect.

And what are our common challenges?

Certainly one is to create the conditions and framework that address the fear of foreign ownership...of selling the

national patrimony...of being owned by Germany, Japan or anyone with money. Ernest Stern spoke to this point this morning.

Another is to try to show client governments the real costs of state owned enterprises. If many of the true costs were known, and the true losses it would help buttress the political will necessary to make these economic changes.

Another challenge is to think together on how to enlist flight capital and relieve debt, focusing on the development of indigenous private sectors.

And too, as we can vividly see in Eastern Europe we must integrate black markets and informal economies into the productive mainstream of a country's economic life.

And lastly, privatization is in vogue in the spotlight these days. You cannot pick up a paper without a reference to it. This creates high expectations...probably too high. The public expects speed and success. We must convey that privatizations are most often slow and frustrating, and sometimes they fail. Privatization has many challenges and concurrently many benefits. The U.S.A.I.D. here to work on these with you all over the world to create market economies, better businesses

and better government and striving toward a global prosperity.
We are all working hand in hand on this idea of
privatization....An idea that is changing the world.

Thank you.

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