

SOEs and risk

Phil O'Reilly

Scale is the justification that's been given for the new 'expanded SOE' policy.

Announcing the policy, the SOE Minister said large New Zealand companies were just too thin on the ground.

To get economic transformation, he said, we need firms with the scale to carry the risks and costs of innovation and development, and to capture the benefits of that innovation.

Many would agree with that sentiment. Size is a problem - so far we haven't been very successful at growing small and medium businesses into large ones. If New Zealand had a Microsoft, or a Nokia or a Nestle, our economy would indeed be transformed.

How can we get firms of sufficient scale?

Business would say: fix the things that stand in the way of small firms getting bigger - reduce tax, improve resource management law and employment law and so on.

The Minister's remedy is different: allow government owned enterprises more room to move, since they already have scale.

This remedy could bring problems.

Some SOEs are capable of wider commercial engagement, e.g. Meridian Energy's successful initiatives here and in Australia - and there may indeed be some good spin-offs for private business from SOE undertakings.

But what about SOE capabilities in, say, 5 or 10 years' time – the sort of time it can take for commercial endeavours to succeed. And would we have a restrained, hands-off Government in 5 or 10 years' time?

SOEs squeezing out private enterprise is a problem. It's not easy for a private company to compete against a state owned enterprise – witness the difficulties the now defunct On Energy had competing against SOE energy retailers during the winter of 2001.

The problem is not just SOEs' financial might, but also their potentially mixed motivations: an SOE with social/non-commercial imperatives as well as commercial imperatives could be an unpredictable competitor.

Investment distortions are another issue. The implicit guarantee of SOEs being bailed out by the Government if they fail puts private business investors in a comparatively weaker position – not a good way to encourage investment in New Zealand.

The SOE Minister's reported comment that the Government would consider making funds available from outside SOEs' balance sheets for the purposes of SOE expanded activities is also concerning. It raises the spectre of cross-subsidies, with the economic distortions they entail - surely something we left behind in the 1980s.

Then there's the problem of blurred roles, with Government as player, owner and adjudicator. The rules could get changed at quite short notice.

Expanded SOE activity expands the risk of political intervention in commercial decisions.

It also increases the risk of perceived conflict of interest by SOE managers. A good example was the controversy over management incentives in Airways Corporation's proposed bid for part of the business of its UK counterpart back in 1999.

Fundamentally, the problem with the expanded SOE policy is risk. The policy is about enterprises with the "scale to carry the risks and costs of innovation and development".

But should taxpayer-funded enterprises be in the business of commercial risk?

The dangers of expanded SOE operations outweigh the potential benefits – the policy deserves a rethink.

Phil O'Reilly is Chief Executive Business NZ