

# **Privatisation and Regulation in South Africa. An Evaluation**

Afeikhena Jerome  
National Institute for Economic Policy (NIEP)  
Johannesburg  
South Africa  
Tel: +27 (11) 484-0784  
Fax: +27 (11) 484-2324  
E-mail: [afeikhena@niep.org.za](mailto:afeikhena@niep.org.za)  
WEB: [www.niep.org.za](http://www.niep.org.za)

3<sup>rd</sup> International Conference on Pro-Poor Regulation and Competition:  
Issues, Policies and Practices, Cape Town - South Africa  
7-9 September 2004

## **Abstract**

Despite the mounting evidence that associates privatization with improved performance, higher profitability, output and productivity growth, fiscal benefits and better access for the poor, there is growing resentment and questioning of the benefits of privatization in the face of some high profile failures especially in infrastructure privatization. In recent years, there is also a post privatization transition towards regulation, especially in infrastructure sectors. This study evaluates South Africa's privatization and regulatory experience. This is particularly relevant in view of growing uncertainty about South Africa's privatization plans in the wake of recent changes in ministerial portfolio after the April 2004 elections.

Arguably, privatization in South Africa had been slow, with few visible results and a general feeling among observers and donors that governments' commitment to the process was generally half-hearted. Consequently, most of the intended objectives have remained unrealised. Despite the growing unease about privatization, it should neither be abandoned nor reversed. It is necessary to "lock-in" the gains and prevent backsliding. There should be a strengthening of efforts to privatize correctly: by better tailoring privatization to local conditions, deepening efforts to promote competition and regulatory frameworks, enforcing transparency in sales processes, and introducing mechanisms to ensure that the poor have access to affordable essential services.

**Keywords:** Privatisation; Regulation; South Africa  
**JEL Classification:** G30, L51

## 1. Introduction

After decades of poor performance and inefficient operations by state-owned enterprises, governments all over the world embraced privatization since the 1980s as a means of fostering economic growth, attaining macroeconomic stability and reducing public sector borrowing requirements. More than 100 countries have privatized well over 100,000 medium and large enterprises in one form or another in the last two decades (Megginson and Netter, 2001).

Although privatization has been relatively less successful than the record in other regions,<sup>1</sup> Africa was not left out in the privatization race. Currently, only nine countries in Africa are yet to initiate a privatisation programme. Even war-torn countries such as Liberia, Rwanda and Sierra Leone have begun to privatise some enterprises. Rwanda, still recovering from the genocide of 1994, has a very active privatisation programme. Namibia is perhaps one of the very few with no plans to privatise, largely because its state enterprises are generally well run (Harsch, 2000 and Ariyo and Jerome, 2003).

Despite the mounting evidence that associates privatization with improved performance, higher profitability, output and productivity growth, fiscal benefits, quality improvements and better access for the poor (Boubakri and Cosset, 1998 and 1999; Megginson et al., 1994; and Dewenter and Malatesta, 2001; Chong and López-de-Silanes, 2003), there is increasing disenchantment with privatization. The initial trend has lost momentum and there is growing resentment and questioning of the benefits of privatization by both populist and intellectuals voices in the face of some high profile failures in infrastructure privatization and concern that privatization does not produce macroeconomic and distributional gains equivalent to its microeconomic benefit. As a result, there is a swing of the pendulum back toward increased governmental provision and supervision (Kikeri and Nellis, 2004).

Privatization has generally been oversold as a panacea for all economic ills, often misunderstood and all too often imperfectly implemented. This holds sway in South Africa where the programme has right from the onset been highly controversial and contentious. There is also increasing recognition of the importance of regulatory framework to counter pervasive market failures as a result of natural monopolies, information failure, externalities and social concern. Governments across sub-Saharan Africa, often at the prodding of multilateral institutions, have established or are establishing regulatory agencies for utilities, inspired mostly by industrial countries model rather than their peculiar national context. In spite of its growing importance, infrastructure regulation has remained under researched in Africa. Arguably, with the exception of South Africa where the literature is gradually evolving, not much is known about the post-privatization transition to utility regulation in Africa, especially within the context of their peculiarities.

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<sup>1</sup> Sales revenue in Africa accounted for 3 percent of total developing country proceeds during 1990–99. Estimated revenues over the decade for 37 Sub-Saharan states totaled \$9 billion, less than the amount raised by sales in New Zealand alone (Nellis, 2003) and about a third of the value of two Brazilian telecommunications auctions in the mid-1990s.

Given the increasing interest in privatization and regulation, this study evaluates South Africa's privatization experience in the light of a decade of democracy. It makes some distinct contribution to the literature. Evaluations of South Africa's privatisation programme are few and disjointed, with many of them assuming an ideological disposition. Existing empirical studies are confined mainly to evaluating water privatisation (Bayat and Moolla, 2003). Apart from complementing the growing volume on privatisation in South Africa (Schwella, 2002, Jerome, 2003 and Business Map 2004), it is the first comprehensive evaluation of the programme a decade after the demise of apartheid. This is particularly relevant in view of growing uncertainty about South Africa's privatization plans in the wake of recent changes in ministerial portfolio after the April 2004 elections.

Arguably, privatization in South Africa had been slow, with few visible results and a general feeling among observers and donors that governments' commitment to the process was generally half-hearted. Consequently, most of the intended objectives have remained unrealised. Despite the growing unease about privatization, it should neither be abandoned nor reversed. Rather, there should be a strengthening of efforts to privatize correctly: by better tailoring privatization to local conditions, deepening efforts to promote competition and regulatory frameworks, enforcing transparency in sales processes, and introducing mechanisms to ensure that the poor have access to affordable essential services. It is necessary to "lock-in" the gains and prevent backsliding.

The remaining part of the paper is structured as follows. Section 2 gives a brief overview of the critical success factors for privatization and regulation while section 3 is on the privatization programme in South Africa. An evaluation of the programme is conducted in section 4, regulation in section 5 and section 6 concludes.

## **2. Critical Success Factors for Privatisation and Regulation**

Despite the extensive adoption of privatisation, it has from the outset been highly controversial and politically charged. This relates to the agency and credibility problems that are unleashed by the exercise as well as its income distribution implications. At the heart of much of the criticism is the perception that privatisation has been unfair, hurting the poor, the disenfranchised and in some cases beleaguered workers (Birdsall and Nellis, 2002). In spite of the fact that there is no universally applicable approach to privatisation, and given that the attempt to apply a "one size fits all" approach has proven ineffective and counterproductive, the literature has identified the necessary features of a legitimate and acceptable national policy. This constitutes a universal benchmark for evaluating the design, implementation process and outcome of national (privatisation) policies and programmes. These include broad-based participation, political commitment, competition and transparency among others.

Privatisation requires strong political commitment. It is intensely political since most transactions produce winners as well as losers and the gains are usually diffused and in the longer-term while the costs are short-term and borne by vulnerable but vocal groups,

such as labour. It thus requires careful handling by the political and administrative leadership to explain alternatives, build coalitions for change, and deal with the disaffected. Top-level political commitment is a necessary but not sufficient condition for successful privatisation efforts. Public perceptions of success are important for the privatisation process. The building of widespread public understanding among a larger group of stakeholders is very essential. In this regard, the availability of information is key. Many countries have found public information campaigns to be helpful. Such campaigns are particularly effective when combined with mechanisms to ensure broad-based participation and mitigate political and social costs (e.g. procedures for transparency, labour programmes, and share ownership schemes in firms being sold).

The difficulties of SOE reform and the substantial empirical evidence on privatisation strongly support the importance of ownership. Contract theory notes, however, that ownership structure matters only if complete contracts cannot be written (Grossman and Hart 1986). Indeed, a handful of empirical studies ascribe performance improvements after sales to competition rather than a change in ownership. Sachs, Zinnes and Eilat (2000), for example, examine the empirical evidence across 24 transition economies and conclude that ownership alone is not enough to generate economic performance improvements. It is when ownership change is combined with institutional reforms aimed at removal of barriers to entry and exit, improving prudential regulation and corporate governance, hardening budget constraints, and developing capital markets that one sees large and enduring progress. Galal et al (1994) also demonstrates that while ownership matters, competitive markets reinforce the benefits of private ownership. Maximum impact is produced when market competitiveness, hardened budget constraints, and improved regulatory frameworks coincide with privatisation. The higher the level of institutional reforms, the more positive the economic performance impact from a change of ownership. At the same time, institutional reforms do not guarantee performance improvements unless there is a minimum level of ownership change. Thus, while ownership matters, policies and institutions matter just as much.

Rapid and extensive divestment without a proper framework can lead to disastrous results as the experience of Eastern Europe has demonstrated (Nellis, 1999, 16-19). For each transaction, proper planning, execution, monitoring, and assessment are necessary. Transparency is an integral part of the privatisation. It includes timely access to relevant information, respect for rules of the game and procedures, as well as control. Lack of transparency often leads to allegations of corruption and provides ammunition to political and other opponents of privatisation. It often creates backlash from investors and the public at large, and threatens to halt the process. In Russia, the mass privatisation program permitted insiders to engage in extensive “self-dealing”, while the subsequent privatisation “auctions” were a massive giveaway of the most important assets at bargain prices to a handful of well-connected oligarchs, who, in the absence of adequate legal and institutional arrangements, continued to act that way (Black, Kraakman and Tarassova, 2000). As a result, the public came to oppose privatisation, associating it with corruption and wealth transfers to a chosen few.

Regulation is now recognised as an important instrument in the development toolkit, which when properly conducted can support market led pro-poor growth and development (Parker and Kirkpatrick, 2003). After a decade of infrastructure privatization and liberalization in Africa and some high profile failures, there is increasing recognition of the importance of regulatory framework. Governments across sub-Saharan Africa, often at the prodding of multilateral institutions, have established or are establishing regulatory agencies for utilities, inspired mostly by industrial countries model rather than their peculiar national context. The main rationale for regulation is to counter pervasive ‘market failures’ where competition is either not feasible or does not produce results compatible with the public interest. In infrastructure industries, this may take the form of natural monopolies where private monopolists may seek to levy prices significantly above marginal costs or public monopolies may allow costs to rise above efficient levels or offer services of inferior quality; information failures such that consumers are able to assess the quality of the service they are paying for; externalities with implications for controlling environmental standards, public health and safety; and social concerns since many infrastructure services are considered essential to life.

When infrastructure reforms were introduced in developing and transition economies, many of them had little or no precedence to guide the design of regulatory mechanisms. Under pressure from multilateral institutions, investment bankers and financial advisers, many of these countries hastily adopted regulatory templates from developed countries. These models were rarely adapted to the political and institutional features prevalent in these economies including lack of checks and balances, limited technical expertise, weak auditing, accounting and tax systems, and widespread corruption and regulatory capture (Laffont, 1996). As a result, such efforts have had limited successes or failed woefully. Many government entities especially sector ministers have resisted giving up their regulatory functions and limiting their roles to policy oversight<sup>2</sup>; assessing industry development and adjusting policies accordingly (World Bank, 2004).

Lessons from the past decade indicate the importance of planning for credible and efficient regulation, including its economic content and institutional architecture prior to reform (Willig, 1999). There is growing consensus around the key design features for a modern regulatory agency. The main features of effective regulation of privatized utilities are coherence, independence, accountability, predictability, transparency and capacity (Noll, 2000 and Stern and Holder, 1999). No matter the sophistry of the regulatory design, utility regulators usually face a number of challenges which has been outlined by Smith (2000). These include:

- Developing and applying the expertise required to address challenging issues in highly complex and increasing dynamic industries. While understanding the technical features of the regulatory industry is clearly essential, the regulator will

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<sup>2</sup> The oft cited example is Morocco Telecommunications where the very successful erstwhile Director of ARNT, M. Terrab had to resign over disagreement with the Secretary of State for Information Technology, Nasr Hejji.

need to draw expertise in economics, finance , law and engineering to understand the art and science of regulatory decisions;

- Resisting undue pressure or influences from political authorities (political capture), who are often interested in short term gains;
- Resisting undue pressure from regulated firms (regulatory capture) to ensure that the balance between consumer and producers interest is struck in their favour;
- Obtaining information from regulated firms. Well informed decisions also require inputs from a diffuse range of consumers, who individually have limited incentives to provide full or accurate information; and
- Exercising their responsibilities in a way that builds public support for their role and decisions, and thus help to sustain reform.

Furthermore, newly created agencies in developing countries typically face more severe constraints particularly when they are established as part of broader reforms including privatization. In the face of weak personnel, non existent data on the regulated firm, they may be required to introduce unpopular tariff increases at a time when privatization remains contentious and consumers have unrealistic expectations about the timing of service improvement.

### **3. The Privatisation and Restructuring Programme in South Africa**

The post-apartheid government inherited well over 300 state-owned enterprises. A startling 50 percent of South African fixed capital assets were in state hands when the Mandela government took office in 1994 while the private sector was dominated by a handful of closely-held conglomerates operating in a loosely-regulated and inherently anti-competitive setting. These enterprises were established primarily to strengthen import-substitution industries, which had started to grow during World War I, by providing infrastructure improvements and basic materials. Eventually, they were used as platform for "white" employment and social benefits as well as creating a support base among the white working class and Afrikaner business owners. These enterprises were incurring losses and the low efficiency of some of them was a source of continued criticism of the government.

In 1985, privatisation was accepted as part of the economic policy in South Africa for many of the same reasons that have made it a new economic creed almost worldwide. State corporations had been the major recipients of large foreign loans that were called in and cut off in 1985, leaving them with serious capital shortages. It was envisaged that sales of the corporations' assets could both ease the debt burden and provide the government with new revenue for much-needed social programmes.

In 1987 the government's position was formulated and spelled out in a White Paper (White Paper on Privatisation & Restructuring, 1987). However, except for the

contracting out of certain government services, for example building and maintenance of roads and toll roads and the introduction of compensatory tariffs, the privatisation drive lost some momentum by the beginning of the 1990s and was eventually put on hold during the period of constitutional negotiations. The initial attempt suffered from two major drawbacks. Many multinational enterprises were reluctant to buy South African enterprises because of international sanctions. More fundamentally, it met with stiff opposition from anti-apartheid organisations and trade unions led by COSATU. The African National Congress which was expected to come to power in the near future perceived it as a ploy to deny them control over the family jewel even after they achieve majority rule.

The results were that of the five state institutions that were originally earmarked for privatisation, only Iscor (a steel company) was eventually sold in 1989 for 3 billion Rand<sup>3</sup> while corporatisation policies, in which government retained ownership, were successfully adopted for others<sup>4</sup> (Schwella, 2002).

For many years prior to the democratic elections in 1994, there had been a heated debate in the ANC and other political organisations about the future of the economy and privatisation was a key issue in this debate (ILRIG, 1999). The position of the ANC has been anti-privatisation deriving from the freedom charter. The first economic blueprint of the new democratic government outlined in the Reconstruction and Development Programme (RDP) was published just before the 1994 elections. It opted for a development state in a mixed economy and an expansive role for the state. On privatization, the RPD was ambivalent and stated that:

“There must be significant role for public sector investment to complement private sector and community participation in stimulating reconstruction and development. The primary question in this regard is not the legal form that government involvement in activity might take at a given point, but whether such actions strengthen the ability of the economy to respond to the inequalities in the country, relieve the material hardship of the majority of the people, and stimulate economic growth and competitiveness.”

In the various debates on economic policy by labour, business and government, there was an agreement that the state needed to be restructured. The disagreement borders more on the nature of the restructuring. While labour opted for a developmental state with increased service provision to redress the backlogs of apartheid, Business preferred a leaner and more efficient state. COSATU held demonstrations in response to privatisation proposals by the newly elected government.

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<sup>3</sup> There had been an attempt to sell ISCOR in 1929 just a few years after its creation but there were no buyers.

<sup>4</sup> The South African Transport Services, for example, was transformed into a public company, Transnet, and the Department of Post and Telecommunications into two public companies, Telkom and the South African Post Office.

The conflict between government, business and labour on privatisation appeared resolved in the National framework Agreement (NFA) signed through the National Development and Labour Council (NEDLAC) in 1995 by COSATU, the Federation of Unions of South Africa (FEDUSA), the national Council of Trade Unions (NACTU) and the government of National Unity. The National framework Agreement (NFA) was the first occasion on which the government and organised labour successfully negotiated around the policy of privatisation. It marked a change in the policy stance of COSATU. Prior to NFA, COSATU had rejected privatisation but in the NFA it accepted that privatisation could take place in certain instances.

On NFA and workers, the Framework Agreement stated inter alia:

“The ultimate aim of restructuring is to improve the quality of life for all South Africans. Therefore, the underlying approach is that restructuring should not occur at the expense of workers in state enterprises. Every effort must be made to retain employment. Where restructuring potentially has negative effects on workers, a social plan must be negotiated with the relevant unions at the enterprise level which takes account of the workers’ interest.”

The NFA outlined the goals of restructuring of certain state assets and the steps that were to be followed in the process. It set up a number of joint structures of government and labour to discuss plans for restructuring.

In June 1996, the government released its macroeconomic strategy tagged ‘Growth, Employment and Redistribution’ (GEAR) which envision a broad based privatisation programme although the term privatisation was not used in the document. It outlined the process of restructuring of state owned assets, the need for appropriate regulatory policies and the creation of public private partnerships (PPPs) in recognition of the limited capacity of fiscus. According to the document:

“The nature of restructuring, as outlined in the framework agreement, may involve the total sale of the asset, a partial sale to strategic equity partners or the sale of the asset with government retaining a strategic interest. Work is in progress to address the outstanding issues on the restructuring of the remaining state enterprises. The restructuring will take place in a phased manner so as to ensure maximum value and adequate regulatory frameworks. Specific policy issues and further elaboration will be dealt with by the responsible Ministers”.

Once GEAR became the economic policy of the government, restructuring was conducted in a number of state enterprises. Thabo Mbeki, then Deputy President announced plans for wide-sweeping privatization programme in late 1995 and this provoked strong protests from labour unions over the threat of job losses and labour’s exclusion from the policy decision.

The programme eventually got underway in 1996 though the sales of enterprises actually commenced in 1997. The government, under pressure from the unions, proceeded very cautiously with what is now referred to as the “restructuring of state assets”.

A policy distinction between “strategic” and smaller “non-strategic” enterprises was initially made by the new government: the partial sell-off of minority stakes in strategic institutions (e.g. the telecommunications sector) was only initiated in 1997, while some of the other smaller “non-strategic” enterprises (e.g. public resorts) were to be sold out of hand once the necessary corporatisation and turnaround strategies had been implemented. Six radio stations owned by the South African Broadcasting Corporation were sold. 30% stake in Telkom was sold to a consortium of United States based SBS Communications (18 %) and Telkom Malaysia Benald (12%) at a value of R750 Million. The interests are held via an investment holding company, *Thintana Communications LLC*. Sun Air was sold for R97 million to a Black Empowerment: The new stakeholders were Rethabile Group (35%), co-ordinated network instruments (19%) and the National Empowerment Fund (15%) and staff (5%). By August 1999, the company ceased operation. This was followed by the sales of 20 % stake in South African Airways (SAA) in 1999 to Swissair for R1.4 billion but repurchased subsequently by Transnet in 2002 due to problems in Swissair. A 20 % stake in the Airports Company of South Africa (ACSA) which controls all major airports in South Africa was sold to Italy’s *Aeroporti Di Roma* and a further “Initial Public Offering” of shares is planned. Strategic management partners were appointed for the Aventura Leisure Group, the Alexkor Diamond Mine and the South African Post Office although the management contract with the New Zealand Post Office was terminated in 2001. About R2.5 billion was also raised from partial sales of Transnet’s holdings in cellular telephone operator MTN. Denel, the Defence firm was partially privatised and foreign strategic partners BAE systems and Turbomecca have been introduced. Some of the nation’s forest and Mossgas were also sold.

The programme, however, suffered from policy credibility. Both the business community in South Africa and organised labour criticised the privatisation process and the attitude of the government. Criticism from the business community (*Business Times*, 25 April 1999) centres on the perceived slowness of the government in implementing GEAR and especially the delay in privatising state assets. Business South Africa argues that the government is sending the wrong signals to the investor community and delaying much-needed investment (Pape, 1998). Labour’s criticism, especially that of COSATU and its affiliates, is based on its analysis that GEAR contradicts and abandons the RDP, and that privatisation of state assets endangers the delivery of basic social needs and leads to loss of employment. Labour also believes that the economy can be kick-started by heavy investment that would lead to consumption and growth (Pape, 1998 and Mostert, 2002).

At a Lekgotla on 29 November 1999, the Interministerial Cabinet Committee on the Restructuring of State Assets (IMCC) directed that a more comprehensive policy framework be prepared to guide the restructuring process into the 21st century. This policy framework would ensure a consistent approach to restructuring across government and address perceived market uncertainties about government’s restructuring priorities.

In August 2000, in what amounted to a renewed commitment to the privatization programme, The Department of Public Enterprises published the Policy Framework for

an accelerated agenda for the restructuring of State Owned Enterprises. The document endorsed NFA's objectives and aims at increasing SOE efficiency through improved governance and competition, while seeking to attract foreign investment, technology, and expertise through full or partial privatization. It anticipates that at least R 40 billion, representing about 5% of GDP would be generated over the period 2002-2004. It targeted the four key enterprises: Telkom (telecommunications), Transnet (transport), Eskom (electricity), and Denel (defence) collectively described in the government's policy framework as 'key enterprises'. They account for the 86 % of the sector's aggregate turnover, 94 % of total income, 77% of all employment in the top SOEs and 91 % of total assets (Mostert, 2003). Completion of the restructuring programme was scheduled for the end of 2004.

New guidelines were also put forward with regard to five key areas, namely the economic and social effects of restructuring; the development of appropriate regulatory and competitive frameworks; promoting empowerment; corporate governance; and improving the restructuring process.

**Table 1: Restructured Enterprises in South Africa (1997 – 2003)**

Restructuring Proceeds since 1997			(R Million denominated)			
State-owned Enterprises	DATE	%SOLD	PROCEEDS	Transferred to National Revenue Fund	Dividends transferred to national	FORM
SABC stations	Mar-97	100%	510.00	510.00	-	SEP/BEE
<b>Financial year ending March 1997</b>			<b>510.00</b>	<b>510.00</b>	-	
Telkom	May-97	30%	5,631.00	1,165.00	-	SEP
Sun-Air (Note 1)	Nov-97	100%	27.00	27.00	-	BEE
<b>Financial year ending March 1998</b>			<b>5,658.00</b>	<b>1,192.00</b>	-	
Viamax	May-98	30%	12.00	-	-	BEE
ACSA	Jun-98	20%	819.00	819.00	-	SEP
<b>Financial year ending March 1999</b>			<b>831.00</b>	<b>819.00</b>	-	
ACSA	Oct-99	4%	173.00	173.00	-	BEE
ACSA	Oct-99	1%	44.00	44.00	-	ESOP
SAA (Note 2)	Jul-99	20%	1,400.00	611.00	-	SEP
Connex	Aug-99	100%	15.00	-	-	SEP/BEE
SASRIA (Note 3)	Feb-00	N/A	7,100.00	7,100.00	7,100.00	Dividend
<b>Financial year ending March 2000</b>			<b>8,732.00</b>	<b>7,928.00</b>	<b>7,100.00</b>	
M-Cell/ MTN	Jun-00	6%	2,400.00	2,000.00	-	BEE
Transnet's Production House	Jul-00	100%	11.00	-	-	BEE
Transnet's Chemical Services	Aug-00	100%	3.00	-	-	SOE-TSI
Transnet's Transwerk Perway	Sep-00	65%	19.00	-	-	SEP
Telkom (Ucingo)	Mar-01	3%	565.00	565.00	-	BEE
<b>Financial year ending March 2001</b>			<b>2,998.00</b>	<b>2,565.00</b>	-	
SASRIA (Note 3)	Apr-01	N/A	3,200.00	2,200.00	2,200.00	Dividend
SAFCOL – KZN	Oct-00	75%	100.00	75.00	-	SEP/BEE
SAFCOL – ECN	Oct-00	75%	45.00	-	-	SEP/BEE
MTN	Jan-02	20%	5,300.00	2,000.00	-	Monetisation
<b>Financial year ending March 2002</b>			<b>8,645.00</b>	<b>4,275.00</b>	<b>2,200.00</b>	
Turbomeca/Aerospace	Apr-02	51%	30.00	-	-	SEP

MTN	Aug-02	N/A	1,100.00	1,100.00	1,100.00	Dividend
Apron Services	Nov-02	51%	117.00	-	-	SEP
Aventura Kareekloof	Jan-03	100%	1.75	-	-	Sale
Aventuar Eiland	Jan-03	100%	5.60	-	-	Sale
Aventura Heidelbergloof	Jan-03	100%	6.50	-	-	Sale
Aventura Roodeplaat	Jan-03	100%	16.20	-	-	Sale
SAFCOL Lourensford	Feb-03	100%	21.50	21.50	-	Sale
MTN Special Dividend	Mar-03	N/A	565.00	565.00	565.00	Dividend
MTN Transaction	Mar-03	N/A	94.00	94.00	94.00	Dividend
CEF	Mar-03	N/A	1,500.00	1,500.00	1,500.00	Dividend
Eskom	Mar-03	N/A	549.00	5493.00	549.00	Dividend
Telkom	Mar-03	25%	4,100.00	4,100.00	-	IPO
<b>Financial year ending March 2003</b>			<b>8,106.55</b>	<b>7,929.50</b>	<b>3,808.00</b>	
Aventura	Jun-03		101.00			Sale
SAFCOL	Dec-03	N/A	50.00		50.00	Dividend
<b>Financial year ending March 2004</b>			<b>151.00</b>	<b>-</b>	<b>50.00</b>	
<b>TOTAL PROCEEDS</b>			<b>35,631.55</b>	<b>25,218.50</b>	<b>13,158.00</b>	

Note 4

**Note 1** – The proceeds from the sale of Sun-Air has been adjusted to compensate for the R1 million received during July 2003

**Note 2** – The SAA Buy-back reduced total proceeds from R 27 billion to R 26.6 billion, representing a significant profit over R 1 billion, that is, sale price in 1999 less purchase price in 2002 (R1, 4b – R0, 4b)

**Note 3** – The dividends received from SASRIA to the amount of R7.1 and R2.2 billion respectively is included due to the fact that the payment of the dividend was made possible due to the efforts of the restructuring activities.

Source: Department of Public Enterprises

In April 2001, a further 3 per cent of Telkom, South Africa's only fixed line telecom operator was sold to *Ucingo*, a BEE grouping. A public listing of the second tranche of 20 % of Telkom shares was due in 2000/2001 but this was delayed due to adverse market conditions. Major privatisations in the year 2002 include the sales of Aventura resorts in January for R29 million, 51 % of Denel's Altimotiv division in July 2002 for R50 million, 20 % stake in cell phone group M-Cell in August and 51 % stake in Apron Services in October for R117 million.

On 14 April 2003, the Minister of Public Enterprises while presenting the DPE Budget Vote to the National Assembly highlighted the major developments in the restructuring of SOEs. According to the Minister, government conducted 11 transactions in 2002 to bring the total number of transactions since 1997 to 27. These included outright disposals, equity sales, participation of BEE groups, dividend payments, proceeds from the rationalisation of interests across SOEs, and the Telkom IPO. Total privatisation proceeds have been estimated at R35.5 billion, with the National Revenue fund absorbing just under R22,5 billion (Jeff Radebe, 2003). Table 1 presents some of the privatization transactions between 1997 and 2002.

No major privatisation took place in 2003 with the exception of the final disposal of Aventura Resorts and the listing of Telkom, the State Telecommunications Company.

Amidst turbulent equity markets, a further sale of 28 per cent stake in Telkom took place in 2003 reducing the government's shareholding to 39 *per cent*. The sale involved a primary listing on the Johannesburg Stock Exchange and a secondary listing on the New York Stock Exchange on 4 March. Proceeds have been however lower than expected, around 0.4 per cent of GDP, compared to a target of 1 per cent, owing to the weak state of the global telecommunication market. Telkom IPO was implemented in the context of the government Black Economic Empowerment objectives, through equity ownership, procurement and skill transfer. In particular, a two-tiered offering was structured to target historically disadvantaged people.

To date, this was the largest global IPO and the largest telecommunications IPO in Europe, the Middle East and Africa since the listing of Burberry in July 2002. However, Telkom continue to retain stranglehold on the sector. Competition, which was legally suppose to commence on 7<sup>th</sup> may 2002, with Telkom losing its statutory monopoly on basic services is being delayed. The SNO and the underserviced area licences had not been licenced as at February 2004 while cheap bandwidth remain elusive.

Since April 2004 elections, there is growing uncertainty about South Africa's privatisation plans. On June 14th, Alec Erwin<sup>5</sup>, the new Minister of public enterprises, told parliament that he had no plans to sell off any of the large state-owned companies that have long been destined for privatisation.

#### **4. Evaluation of the Programme**

The South African approach to restructuring and privatisation is unique as it does not really fit any of the models applied elsewhere in the world. The general thrust puts more emphasis on the restructuring of the state sector than on privatisation. The government is generally not in favour of full privatisation. Rather it has pursued partial privatisation by selling equity to "strategic equity partners" and Black Empowerment Groups while retaining a majority interest (as in the case of Telkom, the Airports Company and South African Airways). In some ways, South Africa has followed the French example where the state remains a majority stakeholder after partial privatisations. However, where the French prefer domestic private investors, the South African approach has been to involve foreign investors, but then only as minority partners (Schwella, 2002). This approach to restructuring and privatisation has been shaped by the political need to maintain the Tripartite Alliance of the African National Congress, South African Communist Party and the Congress of South African Trade Unions (COSATU).

The main objectives of the Government's privatisation initiatives are to facilitate economic growth, promote the development of historically disadvantaged communities and black economic empowerment, extend private ownership of Government-controlled

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<sup>5</sup> According to Mr Erwin, he prefers to make state-owned firms work better first, not to preside over "some sell-off type of privatisation". See the Economist, June 24 2004. South African Privatisation on hold?

assets to employees and to previously disadvantaged persons, reduce the national borrowing requirement, promote skills transfer and promote fair competition. On the macro-economic front, the programme aims to attract foreign investment, reduce public borrowing requirements, assist in the development of an economic context that promotes industrial competitiveness and fuels economic growth.

**Table 2**  
**Worth of State Owned Enterprises in South Africa**

Enterprise	Assets (Rm)	Turnover (Rm)	Income (Rm)	No. of employees	Status	Year to end
Telkom	53,154	37,600	1,630	39,767	60.7% privatised	March – 03
Eskom	81,422	29,684	3,739	32,357	Fully Owned	December – 02
Transnet	55,455	22,099	4,993	550	Fully Owned	March – 03
SAA	15,555	16,324	-5,977	10,855	Renationalised	March – 03
Spoornet	*	11,831	400	34,662	Fully Owned	March – 03
Denel	4,211	4,372	-73	10,754	Fully Owned	March – 03
National Ports Authority	*	4,062	4,632	3,627	Transnet subsidiary	March – 03
Land Bank	17,423	3,927	-1,429	840	Fully Owned	March – 03
IDC	29,802	3,802	787	471	Fully Owned	June – 03
SA Post Office	2,446	3,484	-512	22,169	Fully Owned	March – 02
Rand Water	4,892	2,884	281	3,093	Fully Owned	June – 03
SABC	1,566	2,452	-148	3,054	Fully Owned	March – 03
SA Port Operations	*	2,344	-86	5,645	Transnet subsidiary	March – 03
Foskor	*	2,245	347	549	IDC subsidiary	June – 03
Metrorail	*	1,993	68	8,320	Fully Owned	March – 03
Acsa	3,825	1,589	661	1,797	Partially privatised	March – 03
DBSA	20,919	1,345	1,284	470	Fully Owned	March – 03
Arm Scor	536	876	31	960	Fully Owned	March – 03
Petronet	7,576	760	121	571	Transnet subsidiary	March – 03
Freight-dynamics	296	739	-92	1,179	Transnet subsidiary	March – 03
Safcol	728	692	33	4,706	Fully Owned	June – 03
Sasria	1,306	378	147	17	Fully Owned	December – 02
Alexkor	156	292	6	366	Fully Owned	June – 03
Findevco	1,662	255	70		IDC subsidiary	June – 03
Konoil	7,622	248	247		IDC subsidiary	June – 03
Impofin	1,646	110	9		IDC subsidiary	June – 03
Konbel	10	0.3	*		IDC subsidiary	June – 03
<b>Total</b>	<b>312,208</b>	<b>156,387</b>	<b>8,169</b>	<b>186,779</b>		

Source: Business Map (2004).

Judged against these objectives, the programme has not achieved much. Very large state-owned enterprises (SOEs) remain prominent in the transport, telecommunications, broadcasting, energy and armaments sectors as indicated in Table 2. In the main, the programme has largely focused on divestiture of “non-core business” such as broadcasting stations, resorts, and related services in the transport sector as well as selling minority stakes in utilities to so-called strategic equity partners and Black Economic Empowerment groups.

Since inception, the programme has been characterised by a series of ‘fits and starts’ instead of a consistent approach where government benefit from a learning curve (Jackson, 2004). The tepid approach especially in relation to the four major enterprises has not yielded the desired results. Owing to the slow pace of the exercise, the government has not generated as much revenue as envisaged. By March 2004, total proceeds amounted to R35,6 billion, with the National Revenue Fund absorbing just under R22,5 billion. The total sales proceed since inception is equivalent to just 2.59 per cent of Year 2003 GDP at market prices.

The programme has also delivered very little in the area of black economic empowerment. This is illustrated by the case of Telkom which had a 3 per cent shareholding by a BEE consortium *Ucingo* from its earlier privatisation. The consortium was forced to cede the stake to financiers as it was unable to finance it at listing price levels.

## **5. Regulation in South Africa**

Regulation in South Africa is conducted by a diverse and wide range of independent regulators. Probably hundreds of regulators have been created in the last decade. These are supplemented by many others that function at provincial and municipal spheres of government. In view of the seemingly large number of independent regulators, we evaluate only the utility regulators in electricity and telecommunications.

### ***The Independent Communications Authority of South Africa (ICASA)<sup>6</sup>***

The Independent Communications Authority of South Africa (ICASA) regulates the telecommunications and the broadcasting sectors. It was established in July 2000 by Act No.13 of 2000 as a result of the merger of two previous regulators, the South African Telecommunications Regulatory Authority (SATRA) and the Independent Broadcasting Authority (IBA) to facilitate effective and seamless regulation of telecommunications and broadcasting and to accommodate the convergence of technologies.

ICASA regulates the telecommunications and broadcasting industries in the public interest. Its statutory functions are to make regulations and policies that govern broadcasting and telecommunications; issue licenses to providers of telecommunication services and broadcasters; monitor the environment and enforce compliance with rules,

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<sup>6</sup> ICASA derives its mandate from four statutes. These are the ICASA Act of 2000, The Independent Broadcasting Act of 1993, the Broadcasting Act of 1999 and the Telecommunications Authority Act No. 103 of 1996. See <http://www.icasa.org.za/>

regulations and policies; hear and decide on disputes and complaints brought by industry or members of the public against licensees; plan, control and manage the frequency spectrum; and protect consumers from unfair business practices, poor quality services and harmful or inferior products.

It is the policy of the Government of South Africa that all people should have access to basic telecommunications services at affordable prices. The role of ICASA as a regulator is central to achieving this goal and the ownership and control of telecommunication and broadcasting services by people from historically disadvantaged groups. The Authority promotes the attainment of universal service and access by putting requirements in operator's licences to roll out services in under-serviced areas and ensuring that licensees contribute to the Universal Service Fund<sup>7</sup>.

In practice, the telecommunications sector in South Africa is not regulated in the same way as broadcasting. ICASA is guided by ministerial policy directions, with a severely constrained form of independence as demonstrated in the case study in Box 1.

#### Box 1

Telkom has enormous monopoly power over the fixed line network. While South Africa was hailed as one of the early starters of reform on the continent in the mid-1990s, the strategy of privatization of the incumbent monopoly coupled with period of exclusivity and restrictions on liberalization has not delivered on national objectives.

The price cap method was adopted by a Ministerial determination on 7<sup>th</sup> May 1997 (wrong) and valid for 3 years following section 4 of the Telecommunications Act. There was no direct experience and Telkom productivity data to guide the determination of the productivity improvement factor X. It was negotiated with very limited information and understanding.

In 2001, the new regulator published draft price cap regulation, received public comments and forwarded the decision to the Minister for approval. Telkom lobbied the Minister and approval of ICASA's new price regulation was delayed (political capture). Before the regulation was implemented, Telkom filled for new price increases in 2002 based on the old regime including a 23.9 % increase in local calls. ICASA rejected Telkom's filing and the matter ended in the courts. Finally, a negotiated settlement was reached whereby Telkom's price increase was approved subject to the introduction of a new lifeline service to try and keep customers in the network. This and other amendments were belatedly approved by the Minister on 24 October 2002.

South Africa is one of the few countries where progress in fixed line network development has been declining. The cost of a local 3-minute call at peak time has increased at 26% per annum between 1997 and 2002. By the end of the five-year exclusivity period, two million subscribers have been disconnected due to high price of services. South Africa has slipped in international benchmark comparisons from the best in Africa to fifth.

Source: Adapted from Melody (2003)

<sup>7</sup> ICASA does not however administer the Universal Service Fund, but merely receives monies on behalf of the Universal Service Agency (USA)

### **The National Electricity Regulator (NER)**

South African Electricity industry is dominated by a state-owned and vertically integrated utility, Eskom, which ranks among the five largest in the world. It supplies reliable electricity at amongst the lowest prices in the world. The national electricity utility is commercially run with no recourse to the national treasury. It raises all its finance through debt, off its balance sheet, mostly through issuing bonds, which are well supported by local and international capital markets. The industry has accomplished an unprecedented national electrification programme, connecting about 2.5 million additional households over the past 6 years, thereby increasing the proportion of the population with access to electricity from about one third of the population to about two thirds.

The NER is the regulatory authority over the electricity supply industry (ESI) in South Africa. It is a statutory body established by the [Electricity Act, No. 41 of 1987](#), as amended by the Electricity Amendment Acts of 1994 and 1995. The NER was established on 1 April 1995 as the successor to the Electricity Control Board. The Minister of Minerals and Energy appoints board members, but once appointed, the NER acts independently and reports to parliament. The [Board of the NER](#) consists of a chairperson, a CEO and seven other members, all of whom are knowledgeable and experienced in broader electricity supply industry issues. Members do not act as representatives of stakeholder interests but serve in their individual capacities. The Board is supported by a small, full-time support staff, which includes functional experts in technical, financial, economics, customer and support services areas.

The NER is funded from a levy imposed on generators of electricity, which is passed on to all customers of electricity.

However, there is jurisdictional conflict between the competition commission and NER.

Section 21 (1) of the Competition Act provides that the Competition Commission –

- (h) Negotiate agreements with any regulatory authority to co-ordinate and harmonise the exercise of jurisdiction over competition matters within the relevant industry or sector, and to ensure the consistent application of this Act.*
- (i) Participate in the proceedings of any regulatory authority;*
- (j) Advise, and receive advice from any regulatory authority;*
- (k) Over time, review legislation and public regulations, and report to the Minister concerning any provision that permits uncompetitive behaviour.*

On the other hand, the Electricity Act of 1987 (amended in 1994) gives the NER statutory responsibility to regulate market access to electricity suppliers (through licencing) and to approve all electricity prices. A formal agreement between the Competition Commission and the NER does not yet exist. A common understanding would need to be developed between the two regulatory bodies and government on the scope and pace of restructuring to achieve competition in the electricity industry and the respective roles in overseeing competition.

The NER also has to braze up for pricing challenges as current generating capacity is reaching its limits. The combination of excess capacity, readily availability of cheap low grade coal and innovative coal fired techniques enabled Eskom to become one of the lowest cost<sup>8</sup> electricity producers in the world. Eskom has been able to feed rising demand for electricity over the past ten years during which the customer base increased from 500,000 to 3,5 million while real price of electricity declined by an estimated 15 percent.

## **5. Conclusion**

Ten years after the fall of apartheid and the installation of a democratic government, South Africa has made remarkable progress in all major spheres. Its noteworthy achievements in surmounting economic challenges have been widely acknowledged, especially in the restoration of macroeconomic stability. While significant progress has been made in addressing development challenges, the legacy of the past is still disturbingly apparent. The country still faces a daunting task of reducing unemployment, stimulating economic growth and tackling poverty, which has become pervasive. Dealing with these backlogs, while simultaneously placing the economy on a more sustainable growth path, probably remain the two key conundrums facing policy-makers and economic analysts in contemporary South Africa.

South Africa has the most sophisticated free market economy on the African continent. With only 3 per cent of the surface area, she accounts for approximately 28 per cent of the continent's gross domestic product and 40 per cent of industrial output. She has developed institutions comparable to those in any part of the world with regard to regulatory law and commercial practice. Property rights are generally well defined. The country's well developed legal culture combines elements of several traditions. Much of the law about property, sales and contract can be traced to the Dutch-Roman law that the early European settlers brought with them in the seventeenth century. Company financial and intellectual property derives from English sources, a connection with the 19<sup>th</sup> Century development of large scale undertakings related to mining (OECD, 2003). The financial, communications and transport infrastructure is well developed and modern. The stock exchange is among the world's ten largest. South African entrepreneurs and business professionals are generally highly educated, skilled and competitive. These are all essential features for privatisation. Yet, privatization has been less successful relative to other regions in Africa.

Arguably, privatization in South Africa had been slow, with few visible results and a general feeling among observers and donors that governments' commitment to the process was generally half-hearted. Consequently, most of the intended objectives have remained unrealised.

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<sup>8</sup> An international survey conducted by NUS ranked Eskom's power rates as the lowest among 14 countries. These countries included Italy, USA, United Kingdom, France, Canada and Australia. The second cheapest country Sweden was 58.5 more expensive.

The missing link appears to be the institutional framework. Privatisation or restructuring got under way with no clearly defined 'frames' or 'waves'. Various government departments were involved depending on the industry concerned. The lack of clarity about the different roles both within government and between government and state owned enterprises and other stakeholders created significant bottlenecks.

Despite the growing unease about privatization, it should neither be abandoned nor reversed. Rather, there should be a strengthening of efforts to privatize correctly: by better tailoring privatization to local conditions, deepening efforts to promote competition and regulatory frameworks, enforcing transparency in sales processes, and introducing mechanisms to ensure that the poor have access to affordable essential services.

It is necessary to "lock-in" the gains and prevent backsliding. The piecemeal privatisation efforts thus far now need to be replaced by a comprehensive policy structure replete with legislative reform to create a robust and transparent investment framework. The critical factors in the success of any privatisation programme are embracing privatisation in its totality and not on a transactional basis. The commitment to privatisation in particular and to private sector development in general should be based on pragmatic consideration and the demonstrated benefits associated with such a commitment. A more rapid and wider privatisation programme especially in infrastructure will stimulate competition, allay investors' confidence and encourage private investment and capital inflows.

There are palpable lessons for South Africa from African Privatisation experience especially Zambia, the difficulty in privatising Zambia Consolidated Copper Mines notwithstanding. Unlike several countries where privatisation was undertaken after pressure from multilateral and donor agencies, Zambia privatisation programme was part of the ruling MMD elections manifesto. On ascending power in 1991, the MMD embarked on a rapid process of enacting laws and institutions to enable the process to go ahead. Parliament passed the privatisation act in July 1992 while the Zambia privatisation agency was established two months later. The agencies board included 12 members, nine of whom were appointed by the President from the private sector, but subject to scrutiny by a select committee of the national assembly as well as the assembly's ratification thus providing a high degree of independence from government. The members of the board were drawn from many interest groups including churches, labour unions hence the apparent success in the initial phases of its privatisation programme.

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