Confronting the fiscal crisis through privatisation

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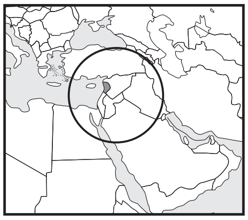

The main reason for privatisation is fiscal. Government officials argue that it is the only way out of the debt trap. However, private firms only invest where they expect to make a profit. The private sector, by its nature, prioritises short-term profit over any other social benefit. All in all, the «public good» value of basic services is considered less important than their fiscal potential.

The main reason for privatisation in Lebanon is fiscal. With 85% of government spending going to fixed expenditures (wages and debt servicing), there is little room for further austerity. Government officials argue that the proceeds from massive privatisation were Lebanon's only way out of the debt trap. The 2003 budget draft includes privatisation, securitisation operations, external financing, as well as expenditure cuts and increased taxes.[1]

In May 2000, Parliament adopted a law that set the framework for privatisation, empowering the government to corporatise State Owned Enterprises (SOE) and allocate proceeds to reduce public debt. The law also created the Higher Council for Privatisation, which determines the SOEs for sale, the time required for restructuring and sale, and the financial value of the institutions. The law also includes provisions for competition, consumer rights, environmental protection and employment for nationals. Nevertheless, privatisation decisions prioritised debt reduction at the expense of other economic, social and political goals.

Telecommunications, electricity and air travel

In 2002, Parliament passed legislation to allow private sector participation in the telecommunication and electricity sectors, while a law addressing the water sector and the national airline is still being considered. Privatisation of large public utilities like electricity, water and telecommunications services can generate significant revenue for debt reduction and reduce the burden on the government's budget. Nevertheless, these play a special role in a country's economy, serving the common interest and providing basic services that are essential to the livelihoods of all. Modern governments have generally assumed the responsibility for providing at least a minimum level of these services to all citizens regardless of income or location. In Lebanon, the «public good» value of these services was considered less important than their fiscal potential. The subsequent brief summary of recent developments with Lebanon's top privatisation candidates will introduce a discussion of privatisation's plausible social side effects, as Lebanon's decision makers have not investigated the policy's social cost, which remains low on the government's priority list.

- *Telecommunications (mobile phone sector).* This sector is the most profitable SOE, generating around USD 500 million in revenues with almost 40% going to the government under the management of two private companies that were established in 1995 according to a Build Operate & Transfer (BOT) agreement. Over the six-year period of private management, prices did not fall. After ending this arrangement (mid 2001) with the two private companies, the government attempted to attract international bids by mid 2002 for long-term operation licenses. However, no investors were officially reported by the set date, and the government decided to redo the licenses' auction towards the end of 2002. Although a State takeover was suggested until another auction takes place, operations remained under the management of the two companies that operate the network for the account of the government to re-open the auction at the end of 2002. All revenues from the current operations (until the end of 2002) revert to the State, with the latter paying the companies value of assets' depreciation and any incidental costs. Thus, the government ensured eventual licenses' sales while securing the continuity of the sector and rejecting the possibility of nationalisation.
- *Electricity: Electricté Du Liban.* In August 2002, the Parliament ratified a law to privatise Electricité Du Liban (EDL), which costs the government LP 400 billion (the equivalent of around USD 265 million) in subsidies annually. Losses are due to poor bill collection and theft, high cost of oil, and technical limitations. The collection ratio currently stands at 51% of the value of power generated and 61% of potential revenues. Consequently, EDL's deficit alleviation can significantly come from the revenue side. The law separated the electricity sector into two businesses: one for the production and distribution of electricity, which will be privatised, the other for the transportation of high voltage electricity, which will remain with the public sector. Forty percent of the electricity production and distribution company shares will be sold to the private sector within the next two years. The law allows for complete privatisation ultimately.
- *Air Travel.* The government did not want to offer (Middle East Airlines) MEA to the private sector before major restructuring and downsizing. Total wages amounted to USD 70 million per year. The airline had cost the government around USD 400 million since 1996. The restructuring plan transferred staff to affiliate companies such as ground and maintenance services, or offered early retirement or unemployment compensation with the help of a World Bank loan. About 1,200 employees were laid off or resigned, triggering conflict between company workers and the government. The dispute was settled by an agreement determining terms of layoffs.

Social impact of privatisation

Although only a post-privatisation empirical approach can assess the true impact of this measure, the following points aim to draw attention to some possible negative consequences that might be the result of privatisation in Lebanon.

Public finance and social spending

The fiscal crisis turned privatisation into a basic instrument to rehabilitate public finances. However, because private firms only invest where they expect to make a profit, they are reluctant to buy enterprises losing money, making major concessions necessary. Even in the case of the profitable telecom sector, the lucrative SOE did not attract investors or bids were not up to the government's expectations, forcing it to extend the deadline. If this profitable sector could not attract enough investment, much less should be expected from ailing SOEs, such as EDL.

The argument that privatisation will generate revenue, which facilitates increased social spending, is particularly weak. Lebanon's social and human

1 http://www.finance.gov.lb/main/govfin/bud03propweb.pdf

TABLE 1

Main privatisation candidates

SECTOR	CHARACTERISTICS	TIMETABLE
ENERGY	17 thermal & hydraulic power plants;1,244 megawatts generated (90% of population needs); Biggest plants: Jiye & Zouk (producing 80% of electricity).	Law ratified in September 2002 to sell 40% of production & distribution.
WATER	85 departments to provide water in the country.	Law to privatise ratified in May 2002; No timetable set; Water management in Tripoli contracted to French company.
OIL REFINERIES	Non-operating currently; 500 employees still enrolled; Two refineries: Zahrani (21,000 barrels/day) & Tripoli (15,000 barrels/day).	Laws under consideration.
TELECOM	1.5 million fixed lines (40% of population); Contractual agreements between private companies & government to run mobile; More than 600,000 mobile subscribers.	Law to privatise ratified; Auction by end of 2002 to get bids for mobile operators.
POSTAL SERVICES	More than 1,100 employees.	Contractual agreement between private company & government.
TRANSPORTATION (Middle East Airlines)	Owned by the Central Bank; USD 100 million loss per year; Expected to break even in 2002; 4,500 employees reduced by 1,200; Upgraded bus fleet and terminals.	Awaiting favorable market conditions.
AIRPORTS & PORTS	Capacity increased to handle 6 million passengers; Another terminal and Queleiat airport are also being rehabilitated; Beirut port handles 60% of imports & 40% of exports; Tripoli is the second largest port after Beirut.	Studies underway to be submitted to Higher Privatisation Council.

development policy is «confined to economic considerations and which have remained captive of sectoral or technical perspectives» as noted in the UNDP Human Development Report (1997). Whether or not social expenditure is increased, it will not resolve the structural problems of disadvantaged groups if there is no official development policy to address such needs.

Investment

Proponents claim that privatisation will be designed to attract much more private investment, which would drive domestic growth and strengthen the external capital balance in key sectors. However, domestic investors in Lebanon are inhibited by a number of factors that diminish overall economic opportunity: reduced government spending, reduced private consumption resulting from additional taxes, a large trade deficit and an investment-savings gap. Although there is no doubt that contractionary measures dampen investment, there are few prerequisites in the Lebanese context that will increase investment under a privatisation policy. Indeed, domestic investment has been stagnant over the past five years.

Similarly, when considering small markets, foreign investors are attracted by stability, high productivity and economic growth, which remain absent in Lebanon. During the 1990s, approximately 90% of net FDI inflows[2] went to real estate, an unproductive sector.

Prices

Privatisation is intended to focus attention on financial performance. Furthermore, improvements in the supply of key services, such as water, electricity and telecommunications, can have downstream benefits for the wider economy. However, there is no unequivocal evidence that the private sector delivers lower prices to consumers than the public sector, unless controlled by an autonomous and capable regulator. Given its profit imperative, private monopolies tend to raise utility prices, having—in the case of basic utilities—a disproportionately negative effect on poor people.

Regarding electricity, EDL is suffering from huge deficits from low collection rates, which result from widespread violations and political exemptions that the government has been almost unable to eliminate. It is unlikely that the private investors will be able to improve collection, lacking the political power to cut exemptions and violations. Although violations by the public sector proved difficult to limit, raising prices would be an easier solution to the private sector to offset this loss because electricity is a basic utility with inelastic demand.[3] However, this would be felt mostly by lower income households.

Reduction of employment

While the impact of privatisation on employment varies across industries, most evidence points towards reductions in employment after privatisation. The usual reason cited for large-scale downsizing is that public entities are overstaffed. Reductions in the number of staff are seen as boosting productivity. However, overstaffing in Lebanon is not the cause of the low public sector productivity. According to the Civil Service Board, public administration has 24,200 civil service positions, yet permanent employees amount to 9,851 and temporary employees amount to 9,353; i.e. there is a shortage of workers.

Moreover, in Lebanon's poor economic environment, laid off workers are unlikely to find equivalent employment. Unemployment grew from 8.5% in 1977 to more than 20% in 2000, and currently over a quarter of the population suffers from full or partial unemployment.[4] In addition, layoffs generally hit unskilled labour harder, putting women at a higher risk because they lack more specialised skills. The risk of layoffs has led workers to compromise their rights. For instance, in the case of MEA many employees were unhappy with the new company's working conditions and opted for early retirement. In such an environment, employers can ignore safety and worker regulations and sweep aside or obstruct the formation of trade unions.

Inequality: transfer of assets to the better off

Privatisation programmes have done much more to enhance efficiency than equity. The negative wealth distribution effect arises primarily from the transfer of assets to the better off. The negative income distribution effect stems from higher prices and lower wages.

The distributional impact of price shifts will depend on the extent to which consumption of the goods and services in question varies by income group and if different levels of consumption, or categories of consumers, face different prices. However, in Lebanon utilities prices are the same regardless of income group. As previously noted, utilities are basic goods with inelastic demand, so changes in prices will disproportionately affect lower income households. Privatisation might improve access to products by means of business expansion, but in most sectors expansion is almost completed.

On the other hand, there are technical problems that would not facilitate an equitable distribution of the SOE shares. The weak capital markets and the very strong banking sector limit the possibilities for most lower income people to obtain financing. Currently, just 0.6% of all bank accounts hold more than 40% of total deposits, earning interest income free of taxes. Private sector participation in SOE will follow this uneven structure, moving the SOEs from public hands into the hands of a very limited segment of society that is able to participate in the privatisation process. Privatisation can therefore contribute to a consolidation of economic and political power in the interest of a group that rarely represents the poor.

In summary, there is an inherent conflict between utility privatisation and the interest of lower income groups because the profit motive—which provides the theoretical impetus for efficiency improvements—creates upward pressure on prices and downward pressure on costs, including workers' wages. The private sector, by its nature, prioritises short-term profit over any other social benefit. ■

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2 Central Bank of Lebanon Annual Report.

3 Electricity demand and usage does not proportionately vary with prices since it is a basic utility.

4 UNDP *Human Development Report 2001-2002*.