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Revenue, competition, growth

Potential for privatisation in the euro area

Privatisation can make a major contribution to the consolidation of public budgets required in much of the euro area. It is not a matter of raising new revenues in the short term to tackle an increasing debt load alone. Rather, countries that are determined to proceed with this task inspire investor confidence, which should have a positive impact on sovereign funding costs.

Moreover, this is a way for a government to bolster growth capacities. It creates opportunities for private-sector companies which, as experience shows, operate more efficiently and are more innovative.

Widespread objections to privatisation efforts do not bear scrutiny. Market failure, often diagnosed prematurely, is not a green light for government to engage in business activity. Privatisation drives should target facilities in the areas of infrastructure and services of general interest.

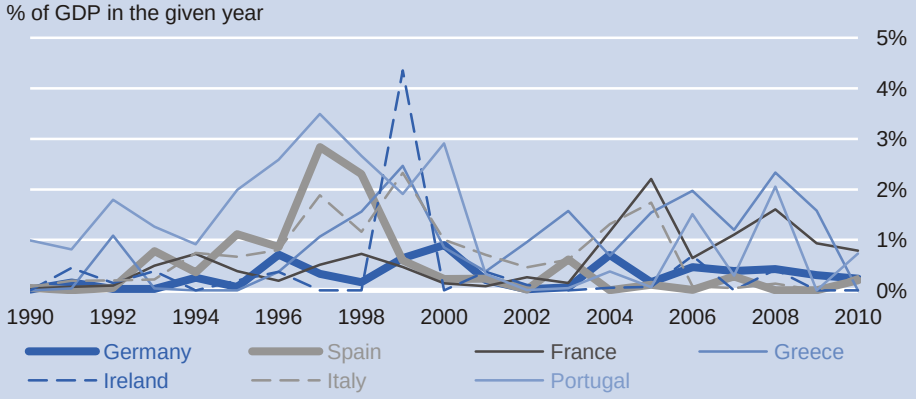
Several successful privatisation waves have swept through the euro area over the past few decades, the telecommunications sector being one example. Nevertheless, considerable privatisation potential is still to be found in the infrastructure segment in particular, and this needs to be tapped.

According to official data, state-owned company holdings account for roughly 5% of GDP in the big countries of France and Italy. The percentage in Spain is likely similar.

The potential for near-term privatisation projects in the smaller peripheral economies ranges between 3¼% of GDP in Ireland and over 6½% in Greece. Note that this does not include potential proceeds from disposals in the real estate sector, which in Greece especially could do much to improve the government's budget situation.

Revenues from privatisation since mid-1990s

% of GDP in the given year



Sources: Privatizationbarometer.net, IMF

www.dbresearch.com

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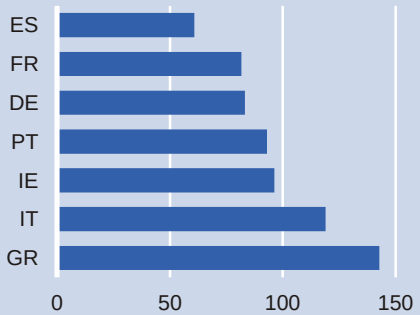
Why privatisation?

The commitment to privatise government property is one of the main components of the restructuring plans imposed by the "troika" of IMF, ECB and European Commission on euro-area countries when they avail themselves of aid from the euro rescue packages.

Sovereign debt in the euro area
Debt as % of GDP (2010)



Source: Eurostat 1

Privatisation provides debtor countries with an opportunity to reap dividends in several respects. Additional revenues help the government to reduce its debts or prevent them from increasing as fast. This can be very significant especially for sovereigns carrying a heavy debt load and labouring under the debt service. But it is not just a matter of direct fiscal effects. Privatisations also enable debt-wracked sovereigns to document the credibility of their budget restructuring programmes and thus send an important signal to international bond investors. This improves the prospects for lower bond yields and sustainably cheaper funding conditions for the government. Given the pronounced interdependence of financial markets in particular, companies should also be able to benefit from better funding conditions. Via positive financial market effects, privatisations can thus become an engine of investment and innovation.

Moreover, by relinquishing business activity the government can directly stimulate GDP growth, because it thus creates new opportunities for private-sector activity. Experience tells us that private companies operate more efficiently and are more innovative. This is evidenced, for example, by the successful privatisations carried out in the telecommunications sector.

It cannot be denied that demands for a privatisation drive in the euro area have also come under fire. Proponents of more state involvement see only little potential for privatisation. Others fear an increase in unemployment. Furthermore, the current phase of lower stockmarket prices is considered the wrong time to start such an offensive.

In the following we shall first discuss in greater detail the pros and cons of privatisations as a means of restoring public finances to proper health. Subsequently we shall analyse the privatisation potential in selected countries of the euro area.

Priority for private business activity

State not suited for assuming role of entrepreneur

From a regulatory standpoint there is little scope for government involvement in business, so in many countries there is, in principle, large scope for privatisations. In a market economy private-sector activity ought to take precedence. The state is not suited for assuming the role of entrepreneur. There is too much of a risk that state-run operations could be geared to political objectives and could ignore market forces, the result being an economy whose output of goods and services does not dovetail with the wishes of consumers. Another argument for the superior efficiency of private companies is the fundamentally more efficient allocation of capital resources and better possibilities for setting appropriate performance incentives for employees and management. Capital market funding enables investment plans to be made on a long-term basis, whereas public-sector budgets are usually approved for short periods. Various studies confirm that the productive efficiency of

privatised companies increases.[1] In a world of globalised markets this is more important than ever before. Only the competitors that can meet international challenges will survive in the market and thus safeguard jobs.

In order, however, to create the best incentives possible for efficient entrepreneurial activity and ensure that microeconomic efficiency benefits lead to macroeconomic gains across the broadest spectrum possible, it is necessary to provide a competitive environment by means of open markets. Competition ensures constant improvements to the goods and services offered. Companies that do not want to have to exit the market are compelled to continually improve their product in terms of price, quality and technology.

Public goods

One main characteristic of public goods is that users can consume them without affecting their availability for others (referred to as non-rivalry of consumption). Another characteristic is that it is difficult to define the circle of users, i.e. individuals cannot be excluded from the consumption of public goods, or only at a disproportionately high cost (non-excludability).

Efficiency benefits of private business activity in a competitive environment argue for a clear division of duties in a market economy. The government should not interfere in market activities. However, it must ensure that there are appropriate rules and frameworks in place to enable the interplay of market forces. Apart from the enactment and implementation of a market-based legal and competitive order, this includes other sovereign tasks such as internal and external security as well as foreign relations. These are referred to as "public goods". The private sector fails to create (sufficient) supply of such goods because there is a dearth of price signals and thus of production incentives.

Even in cases of market failure ...

As government activity in a market economy has fundamentally distortive effects, there needs to be compelling evidence to justify its involvement. In the case of the public goods cited above, this point is not at issue. However, advocates of extensive government activity see evidence of widespread market failure, even though this diagnosis is frequently incorrect. Moreover, even when markets fail this does not necessarily always warrant entrepreneurial activity on the part of the state. Rather, the government can usually create market-like conditions via appropriate regulation as the basis of private-sector activity even in the face of (alleged) market failure.

... the state can create market-like conditions for private-sector activity via appropriate regulation

Therefore, priority for private-sector activity needs to be attached not only to the extensive area of private goods, but in principle also to fields such as infrastructure and what are referred to as services of general interest that are largely regarded as part of the public domain. Network-based infrastructure is frequently cited in connection with market failure because atypical cost effects here can favour the emergence of monopolies. However, this objection holds at best for the networks themselves (e.g. railways and power grids), but not for the goods transported across them (e.g. train services and electricity). Similarly, externalities in the field of services of general interest do not fundamentally block the privatisation of such services.

Apart from theoretical reservations, though, there are also pragmatic objections to the demand for a privatisation drive in countries that are deep in debt. For instance, some critics fear there will be waves of job redundancies at privatised companies, further boosting the already high unemployment levels in many areas and entailing negative consequences for the economy as a whole. Others consider the privatisation of public assets and government activities in this current phase of low market prices to be the wrong approach. A further contention is that calendar targets for extensive

[1] Megginson, William L. and Jeffrey M. Netter (2001). From State to Market: A Survey of Empirical Studies on Privatization. Journal of Economic Literature Vol. XXXIX. pp. 321-389.

privatisations would weaken the negotiating position of the countries concerned.

Privatisation approaches

The widespread objections to privatisation suggest it would be a good idea to take a somewhat closer look at the potential scope in the three relevant areas: commercial activity, infrastructure and services of general interest.

1. **Commercial activity.** There is no valid justification for government ownership of entire companies or even stakes in firms that operate in open, competitive markets. On the contrary: this is one area where the state's exit would be advisable. In such cases the government has no good reason for competing with private-sector entities and depriving them of market shares. This is all the more problematic inasmuch as it is impossible to engage in fair competition against state-owned companies that do not have to rely on generating a profit.

State-owned enterprises distort competition

This is why the demand for privatisation also holds for successful state-owned enterprises. While such holdings may produce a fiscally welcome stream of revenues for government coffers, the state undermines competition in the process and takes entrepreneurial risks which have nothing to do with its actual mandate. Highly indebted sovereigns with heavy debt service obligations in particular would probably stand to benefit from the disposal of corporate stakes no matter what the case. As a consequence, such countries will also cease to be able to follow their inclination to protect state-owned companies in difficult times to save jobs, even if they are permanent lossmakers.

2. **Infrastructure facilities.** In the event of privatisation, infrastructure and related companies are the very areas expected to generate significant efficiency gains for the economy as a whole. The telecommunications sector is a case in point. The wave of privatisation and market deregulation in the EU during the 1990s played a major part in boosting innovation and productivity in this sector. Without it, such a rapid proliferation of modern IT solutions (mobile phones, internet, mobile internet etc.) and the sharp drop in the price of many telecommunications services would not have been possible. Low prices, numerous innovative products and strong employment growth in the expanding areas of telecommunications and value-added services are proof that many have benefited – the government, business and the consumer in particular.

Restructuring under state control?

One open question is whether and to what extent state-owned enterprises should be restructured before their disposal. On the one hand, competition factors argue for such a step – above all the unbundling of large state-owned companies with a monopoly. On the other hand, microeconomic factors have to be taken into consideration, that is restructuring efforts may target an increase in company efficiency. Generally, of course, it probably makes more sense to leave micro-economically necessary restructuring jobs to private investors. In some circumstances, though, the government can generate higher proceeds if it creates new structures before the disposal. One way would be via mergers, which are hard to establish ex post.

Unlike telecommunications, other areas such as parts of the energy sector and transport (rail in particular) have yet to see a rigorous EU-wide privatisation and deregulation thrust. But several factors, such as the high capital requirements and the importance of innovations, suggest that in the energy sector, for instance, the change of tack towards a greater proportion of renewables could be better accomplished with decentralised private-sector structures rather than public-sector ones.

The segments cited (rail transport, energy supply as well as water supply and disposal) are network-based services. As long as it is not possible in such cases to clearly differentiate between network operation and actual service, they are referred to as natural monopolies. The concentration of production in one single such company or a few generates sizeable cost benefits. However, today's technologies make it possible in various

Partial versus full privatisation

To attract as many investors as possible one sensible option may be to spread asset disposals over a certain period of time. The greater the number of investors demanding the assets, the higher the proceeds are likely to be. Under certain circumstances such a strategy is helpful also in times of financial market turmoil and generally subdued share prices. By taking a few steps at a time the government can document its fundamental willingness to dispose of its holdings, yet not forgo the chance of attaining higher proceeds in future. Of course, it should have more than just vague hopes of doing so. Regardless of this aspect, the question arises whether the same sort of fate might not await heavily indebted states as private entities which, in comparable situations, usually have to sell their assets.

Privatisation agencies

The success of privatisations may be enhanced by appropriate procedures and institutions. The OECD recommends the use of a privatisation agency for major projects which justify the related costs.* Given such an agency it is probably easier to, among other things, recruit experts – also from the private sector. Besides, this can boost the transparency of the process. Interested investors are presented with an institution as a contact and negotiating partner.

Another conceivable option is to bundle the assets in a fund. This was the route taken by Germany with its Treuhandanstalt when the state-owned firms of the ex-GDR were privatised. But this very example shows that at the end of the day the value of the businesses to be privatised invariably decides the size of the potential receipts.

* OECD (2010). Privatisation in the 21st century – Summary of recent experiences.

sectors that used to be considered natural monopolies to exactly capture the network services performed (e.g. volumes of energy, water etc. transmitted) and separate them microeconomically from the value added in the production of the good transmitted. In such cases, at most the networks themselves assume the property of a natural monopoly. By contrast, there is little to be said against private-sector production of the services or supply products themselves. In this context, the government can ensure via suitable framework conditions and stipulations that the security of supply and quality are guaranteed. And even the operation of networks can, as a rule, be privatised by means of appropriate procedures (especially licences).

3. **Services of general interest.** In principle, there are also benefits to be derived from the privatisation of government services of general interest, e.g. water supply and disposal, healthcare facilities and non-sovereign administrative tasks.[2] Fundamentally, these are private goods. No doubt there are reservations concerning privatisation especially in these segments.[3] One issue, for example, is the security of supply in respect of quantity and quality. The government should address this aspect at the time of privatisation, perhaps by resorting to stipulations (quality standards, delivery commitments).

   Governments tend to offer services of general interest at cheap prices in order to keep the services affordable for broad swathes of the population. However, this is not an argument against privatisation per se. Subsidisation is a misguided approach to social policy. It is not necessary when such services are privatised. In these cases, financial support for low-income users is the cheaper and more accurate method of achieving social policy objectives.[4] Nonetheless, it is particularly in the area of services of general interest that the (short-term) fiscal effects of privatisations should not be overestimated. For example, facilities (such as hospitals) that are not covering their operating costs and/or are in debt can probably only be disposed of at a corresponding discount. Nevertheless, privatisation will usually make sense here, too. This is one way the government can reduce its future payment obligations, while offering the facilities the chance to be successfully restructured in private hands.

Not even the difficult situation in the financial markets represents a general obstacle. One possible avenue could be to assign the assets to an agency that has a clear mandate to privatise them. The

[2] See Böttcher, Barbara (2003). "Services of general interest" – an alibi for state economic activity? Deutsche Bank Research. EU Monitor No. 6. p. 3ff.

[3] These exist partly because privatisation benefits here are a matter of dispute. Much relies on there actually being competitive pressures on the related entities after privatisation. This argues among other things for the duration of licence agreements being as short as possible, while the transaction costs connected with the granting of licences argue for longer terms. For more on this subject, see Bel, Germà and Antón Costas (2006). Do Public Sector Reforms Get Rusty? Local Privatization in Spain. The Journal of Policy Reform Vol. 9, No. 1. Online edition: http://www.ub.edu/graap/bel-costas.pdf.

[4] As long as essential services of general interest are to be provided that are not attributable to individuals yet in the public interest (owing to positive externalities), the government should procure these services from private providers and pay for them. One example here is the requisite capacity reserves in hospitals in times of crises such as epidemics. As a rule, such a solution is cheaper than to run the facilities as state-owned operations. However, the greater the convergence of strong externalities, a substantial need for social-policy action and the necessity of securing supply in terms of quantity and quality for individual areas of services of general interest (e.g. schooling), the more it may make sense for the government to step in.

agency may then conduct the disposals over time depending on market conditions. In this way the countries may build trust without having to dispose of assets at an overly hasty pace.

Privatisation in the European context

A slew of privatisations have taken place in Europe over the past few decades. Margaret Thatcher got the ball rolling in the early 1980s with the gradual reduction of the British government's share of the economy from 10% of GDP to nearly 0%.[5] In the 1990s, the trend spilled over to virtually all of Europe. Not only the renewed focus on market economics following the decline of socialism but also stimuli from European institutions played a major part. For one thing, legislation calling for the opening of markets resulted in substantial pressure on governments to dissolve their existing monopolies and thus – in connection with tighter restrictions on government aid – to privatise the public activities and facilities concerned. For another, fiscal aspects had already started back then to assume a key role. EU member countries used privatisation receipts to be able to improve the position of their public budgets in the run-up to the launch of the European Economic and Monetary Union and thus to fulfil the fiscal convergence criteria of the Maastricht Treaty.

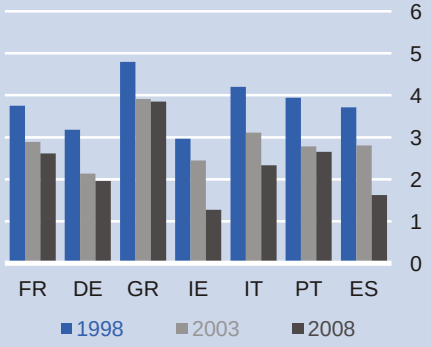
The governments focused primarily on the disposal of holdings in state-owned companies in the telecommunications and energy supply sectors. As shown in the chart on the cover page, most of the EU countries recorded their highest privatisation receipts during this period. France and Greece are among the exceptions to the rule, as they implemented related reforms mainly in the past decade.

Countries such as Germany and Ireland that sold off fairly extensive volumes of assets between 1998 and 2000 benefited from the boom in the equity markets at the time. In France, by contrast, it appears that the privatisations were timed without regard for the sentiment in the share markets.

The surge in privatisation activities around the turn of the century is also to be seen in the OECD's *Indicator of Product Market Regulation*, last updated in 2008, which measures market regulation in individual countries.[6] Moreover, the indicator highlights that in some countries the degree of state control over business enterprises sharply declined during this period and later. This is attributable to reform delays and/or initially only partial privatisations in various countries.

Companies often used to be only partially privatised in order to further secure the state's sphere of influence (via golden shares, for instance). However, if the government retains substantial powers or perhaps even a right of veto on strategic decisions, this endangers the adaptability of the company concerned and hampers its proper valuation. This is likely to lessen the interest of private investors, since long-term investments become riskier. Studies show as well that fully privatised companies are more profitable and more productive.[7]

OECD regulation indicator
Increase in public ownership from 0-6*



*State control indicator, see footnote 6

Source: OECD Statistics 2

Golden shares

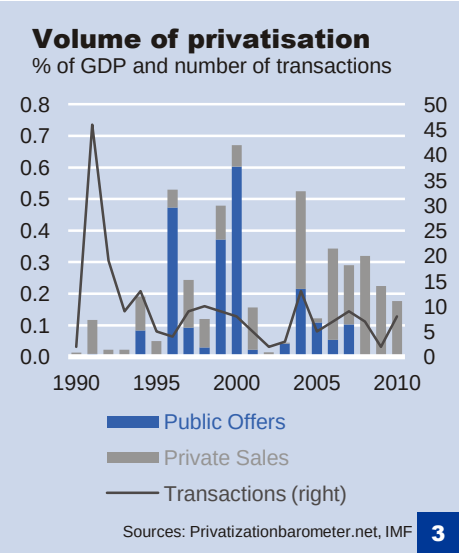
Golden shares secure their owners special rights enabling them to significantly influence management decisions made at the respective company. As a rule they have been introduced during privatisation drives so the government can continue, for example, to block the sale of company stakes. This is meant to ensure that national interests are represented in strategically important companies and sectors. It is recommended that the function of golden shares have a "finite life span" and be "invoked rarely so as to not undermine confidence in government non-interference".*

* OECD (2003). Privatising State-Owned Enterprises – An Overview of Policies and Practices in OECD countries. p. 116.

[5] Megginson/Netter (2001), p.1.

[6] The indicator consists of various components. The relevant component in this case is *state control,* 50% of which is calculated by the pervasiveness of *public ownership* and 50% by the pervasiveness of *involvement in business operations*. The scale ranges from 0 to 6, the greater the amount of state control, the higher the indicator. See http://www.oecd.org/dataoecd/32/9/42131723.pdf

[7] OECD (2003). Privatising State-Owned Enterprises – An Overview of Policies and Practices in OECD countries. p. 35.



Treuhandanstalt

Germany's reunification also marked the beginning of a new chapter of privatisation in that country. All the larger firms in the ex-GDR were owned by the state. Before the fall of the Berlin Wall, however, the GDR government gathered them under the roof of the Treuhandanstalt. It was mandated to sell these holdings. The originally expected proceeds were to be disbursed to the citizens of the former GDR. Ultimately, however, the Treuhandanstalt wrapped up its mandate with sizeable losses since most of the firms had held little appeal for investors owing to their lack of competitiveness. In many cases the disposals were subsidised, at times heavily.

Economists offer differing assessments of the Treuhandanstalt's work. Most agree that its chances of success were hampered not only by the substantial time pressure under which the privatisations were carried out and the concurrent collapse of the ex-GDR firms' traditional customer markets in Central and Eastern Europe, but also by the relatively rapid pace of wage convergence. Another issue, though, is whether there was any realistic alternative to the rapid, extensive privatisation considering the growing wave of migrants leaving the east German Länder in the wake of reunification.

Germany – potential mainly at Länder and municipal level

Germany can look back on a history of successful privatisation policy, at least at the federal level. The Federation had largely reduced its holdings in industrial companies and energy supply utilities with an initial privatisation phase in the 1950s and the first half of the 1960s as well as in a second phase in the 1980s. By the end of the second phase there were still sizeable federal holdings in the logistics, telecommunications and transport sectors, however.

By the end of the past decade, though, the Federation had divested substantial chunks of these stakes, too. In this context, the focus in the 1990s was on the restructuring of the former special assets of Deutsche Bundespost to turn them into holdings under private law which were later partially privatised in several steps. The Federation currently holds approximately 15% of Deutsche Telekom AG. A further roughly 17% is in the hands of state-owned KfW. KfW also holds 30.5% of the shares in Deutsche Post AG. The Federation has not held any more direct stakes in this company since mid-2005. The biggest company still under federal ownership is Deutsche Bahn AG (including the Residual special asset of the federal railways). During the given privatisations the Federation was able to generate substantial revenues in certain years, particularly in 1999 and 2000 when the stakes were sold in a favourable market environment (in 2000 the proceeds equalled nearly 1% of GDP). The privatisation of former GDR assets by the *Treuhandanstalt* (a special body charged with privatising formerly state-owned companies) must be regarded as a special case (see box).

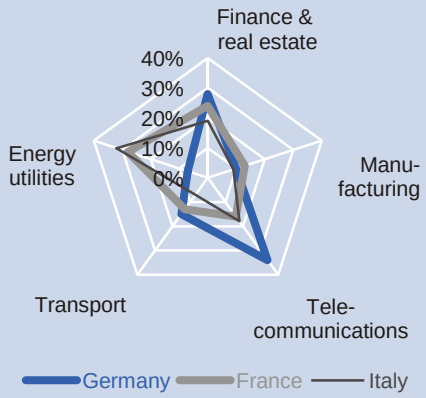
Unlike the Federation, the (west German) Länder (federal states) usually were slow to start disposing of corporate holdings. Some of the Länder also remained less rigorous than the Federation in their approach. Lower Saxony is a case in point as it still owns major stakes of around 20% in Volkswagen AG[8] and 26.5% in Salzgitter AG. At the end of 2010 Baden-Württemberg actually re-expanded its holdings with the acquisition of approximately 45% of the shares of energy utility EnBW. Moreover, several Länder hold stakes in airports. Furthermore, the Länder all have numerous holdings in small and medium-sized businesses ranging from breweries and horse-breeding farms to vineyards. Above all, the bulk of the Länder are also still involved – in varying forms – in the Landesbanks. In the wake of the financial market crisis different Länder have even broadened their exposure. However, some Länder are planning to pull out of their Landesbanks or, like Bavaria, have already set the wheels in motion.

Looking at the municipalities, which assume a key role in providing services of general interest, there are limits to the scope for general statements, as with the Länder. This holds already if for no other reason than that factors such as the budget situation and the political leanings of the decision-makers, who have a major say in privatisation activities, differ substantially. Certain patterns may be recognised, notwithstanding. For example, in the past two decades there was a certain trend towards the privatisation of municipal utilities ("*Stadtwerke*"). Municipalities turned over energy supply functions in particular, and in some cases also water supply utilities,

[8] Moreover, the so-called VW Act secures Lower Saxony a right of veto on all important decisions to be taken by Volkswagen AG. A decision handed down by the ECJ (October 23, 2007) allowed the European Commission to demand that Germany relinquish this veto right. IP/08/1797. November 27, 2008.

DE, FR & IT in comparison

% of receipts up to 2010



Source: Privatizationbarometer.net 4

to private hands or set up public-private partnerships in order to fulfil the respective duties in tandem with private-sector companies. In many areas municipal clinics and hospitals were also privatised during this period. The share of private clinics in the total number of hospitals thus more than doubled between 1991 and 2009, from 14.8% to 32%, while the share of public hospitals fell from 46% to 31%.

Over the past few years, however, the privatisation trend has largely ground to a halt. In the energy segment there are in fact signs of a reverse trend. Various municipalities have started to boost their stakes in partially privatised enterprises again. Furthermore, in the early years of the game municipalities were also quick to accept so-called sham privatisations, i.e. the hiving-off of business activities in private-sector companies which then remained fully or partly under municipal ownership.

One further issue is the ownership of real estate, woodland in particular. In Germany, over 5.7 million hectares of woodland belong to the government. This corresponds to 54% of the total. In some cases, though, the properties in question are conservation areas.

France

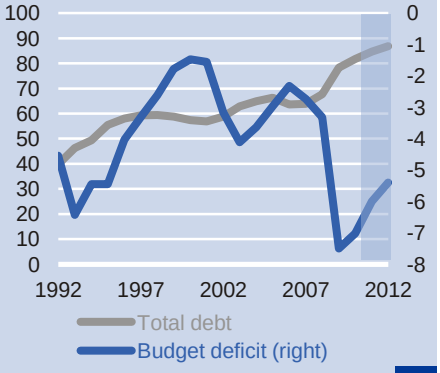
In France, an economic model tending to embrace government involvement resulted for a long time in, among other things, a relatively large proportion of public-sector enterprises. As recently as 1985 state-owned enterprises generated 15% of GDP. The central government's portfolio comprised not only extensive holdings in the energy, logistics, telecommunications and transport sectors, but also major stakes in industry and the financial sector. Noteworthy privatisation measures were not started until the second half of the 1980s.

Among the initial major privatisation steps were the reduction of stakes in banks (e.g. Société Générale and Paribas, both in 1987). These were followed by disposals in the industrial sector, initially in the automotive sector, but from the end of the 1990s even in the defence industry. This last-mentioned period also marked the start, as in various other countries, of privatisations in the telecommunications sector and media industries. France disposed of major stakes in the energy sector later than countries such as Germany. However, the French government generated a substantial amount of revenue this way, from the middle of the past decade in particular. This resulted in the budget deficit being slashed noticeably. Privatisation receipts totalled nearly EUR 38 bn in 2005, or roughly 1.7% of GDP.

Policymakers in France have privatised segments of infrastructure and services of general interest to a fundamentally greater extent than has been the case in Germany. The privatisation of the French motorway network is considered a model of success. The concessions for the operation of the motorways may be put out to tender anew after 25 years, since the autoroutes themselves were not sold.[9] Another example is water supply/disposal, a job of the muncipalities also in France. However, to fulfil their mandate about 75% of the municipalities turn to private-sector providers who are awarded contracts for services via tender. In the hospital sector, private providers account for a market share of roughly 25% in terms of total beds (Germany: 17%).

France: National budget

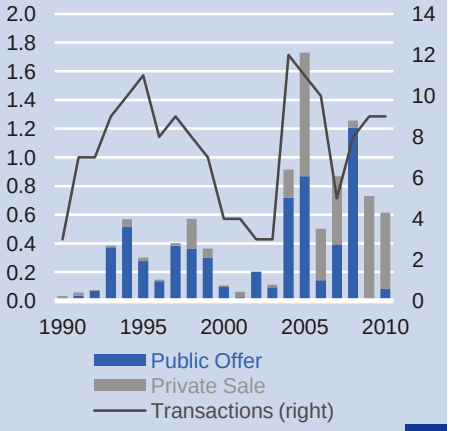
% of GDP



Sources: Deutsche Bank, OECD Statistics, AMECO 5

Volume of privatisation

% of GDP and number of transactions



Sources: Privatizationbarometer.net, IMF 6

[9] Similar procedures seem to be an obvious solution for rail transport and port operations as well.

Regardless of the increase in privatisation activities over the past decade, the French state still owns a substantial volume of assets. This results partly from the fact that some of the larger companies have been only partially sold to private-sector entities. Moreover, the railway company SNCF, for instance, and logistics provider La Poste are still fully state-owned enterprises. Major airports are also still completely or largely in the hands of the state.[10]

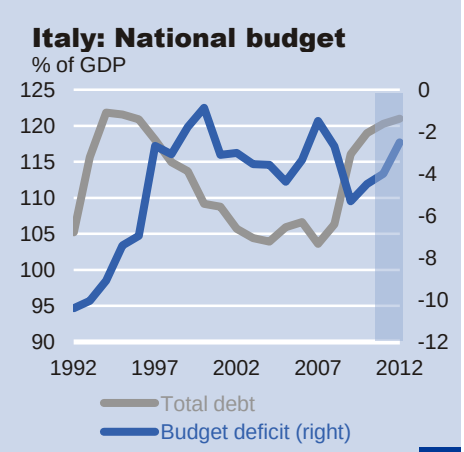
According to the Agence des participations de l'État, the French government's portfolio of corporate holdings had a market capitalisation of EUR 88 bn on September 1, 2010[11], or roughly 4.6% of GDP.

The government's influence on the economy is more pervasive than these figures indicate, though. There are (partially) privatised companies particularly in the infrastructure segment that enjoy numerous benefits. While the concessions for the operation of hydropower stations are at times awarded anew, for instance, only the new operators are required to pay fees to Paris. EDF by contrast, which is 84.5% owned by the French government, does not pay any fees. In addition, its electricity tariffs are regulated, so market entry into the household segment remains difficult.[12]

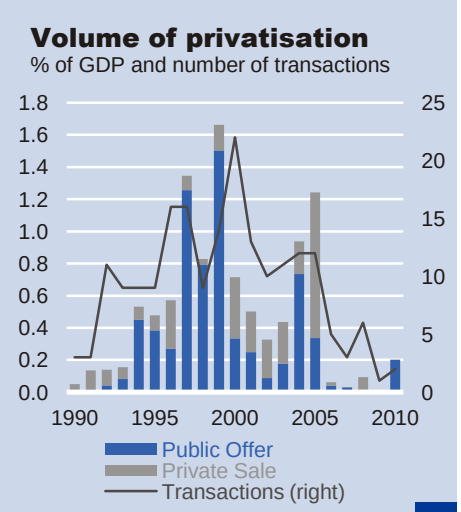
Italy

The government was a major player in the Italian economy for a long time. For a while, the *Istituto per la Ricostruzione Industriale*, a holding company, owned a portfolio of 1,000 enterprises and employed up to 500,000 people. Finally, in the 1990s, an extensive privatisation and deregulation process reduced the volume of government holdings. This process also revealed inefficiency and misallocation of resources, especially since public-sector companies served not least to preserve jobs. More than half of the privatisation receipts were generated between 1997 and 1999 when state-owned enterprises and facilities were (partially) privatised in the telecommunications, energy (especially ENEL), infrastructure (incl. motorways) and transport sectors. However, today the government still owns stakes in the large energy supply utilities and in aerospace technology. Furthermore, so far the privatisation drive has in many cases not applied to firms at the municipal level. One noticeable exception here, though, is the banking sector, which the municipalities and the government in general largely exited in the course of the past ten years.[13] The municipalities offer the greatest privatisation potential, notwithstanding.

In a report tabled at the end of September 2011 the Ministry of Economy and Finance estimated that the remaining corporate holdings had a total value of EUR 80 bn (or roughly 5.2% of GDP).[14] Furthermore, the plan to grant concessions could generate around EUR 70 bn in revenue. Besides, this step could boost competition.



Sources: Deutsche Bank, OECD Statistics, AMECO 7



Sources: Privatizationbarometer.net, IMF 8

[10] The French government has announced that it intends to dispose of 50% of the shares in four regional airports (Lyon, Toulouse, Bordeaux and Montpellier). However, the respective municipal governments that already hold stakes of 15% apiece say they want to acquire these shares themselves.

[11] Agence des participations de l'État (2010). French State as a shareholder. Report 2010. p.4.

[12] Schmieg, Andreas (2011). Frankreichs Privatisierung der Wasserkraft. Frankfurter Allgemeine Zeitung No. 172. p.11. Juli 27, 2011.

[13] Polster, Armin (2004). Italy's savings banks: first reforms create big universal banks with untapped potential Deutsche Bank Research. EU Monitor Financial Market Special No. 17.

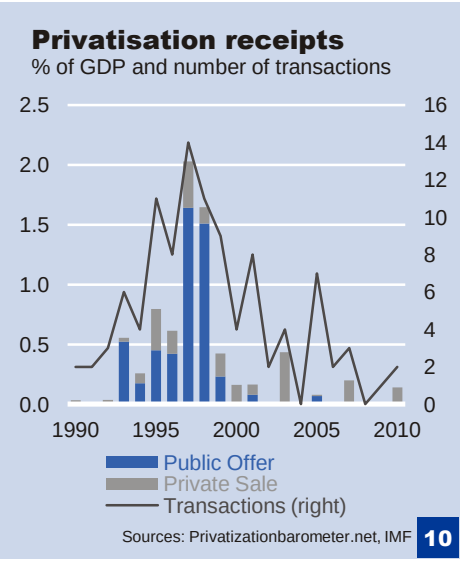
[14] Scalera, Stefano (2011). La valorizzazione del patrimonio delle Amministranzioni Pubbliche. Dirigente Generale, Direzione VIII. Dipartimento del Tesoro. Rom. September 29, 2011.

On top of this, the Ministry's plan envisions income of EUR 10 bn for the granting of CO_2 emission rights.

Particular attention should be paid to public buildings and property. Cassa Depositi e Prestiti says their total value runs to EUR 421 bn. This institute estimates that real estate worth EUR 42 bn is not being used at present. For this reason it could probably be put up for sale with relatively little effort or expense. Since the real estate largely belongs to the municipalities, the government ought to set out a well-structured process in advance. As things stand today, the Ministry of Economy and Finance expects proceeds from real estate disposals to total EUR 25-30 bn besides cost savings of an initial EUR 3 bn per year.[15]

So going by the official information, the government's assets (incl. those of the regions and municipalities but excluding potential proceeds from the sale of emission rights) add up to EUR 571 bn, or close to 37% of GDP. Of course, the potential can also be expanded. The OECD for one recommended privatising further parts of the infrastructure, such as the water supply system in particular. Precisely this last proposal seems to make sense, especially as there is a pronounced need for investment in this area – manifested above all in heavy losses totalling 30% of the water distributed. However, this faces the hurdle of a referendum.[16] All in all, the OECD determined a sizeable need to deregulate structures and open the markets.[17]

Up to now, Italy has sought to maintain its influence in privatised companies. This is shown for example by the European Commission's request in February 2011 that Italy amend a law which enables the government to prevent individual investors from buying shares of privatised companies in strategically important sectors.[18] However, the Ministry's most recent economic programme strengthens hopes that the government has now embarked on a new path.



Spain

The Spanish government was relatively heavily involved in the business sector during the 20th century on account of the political situation. Then, in the second half of the 1990s, the government of José María Aznar launched a series of effective structural reforms. The proceeds from privatisations in the area of chemicals (Repsol YPF), energy supply (ENEPSA), telecommunications (Telefónica) and the airline Iberia helped to reduce the sovereign debt and stimulated an economic upswing. While Spain had still reported a budget deficit of 6.5% of GDP in 1995, it swung to surpluses of 2% and 1.9%, respectively, in 2006 and 2007. However, following the latest crises Spain has again had to grapple with sizeable deficits (2010: 9.2%) and increasing sovereign debt.

Now, further privatisations are planned to pave the way out of the crisis. In the event, one major focus will be on the disposal of (stakes in) airports. For this purpose, AENA, a company that operates airports in Spain and abroad besides offering navigation

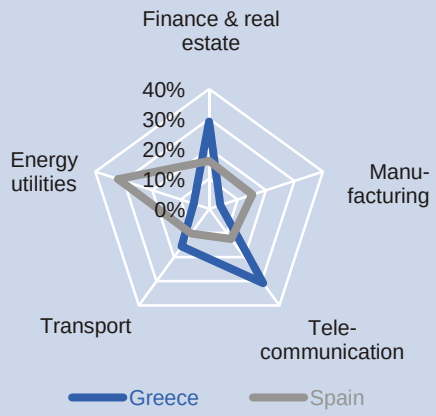
[15] From 2020, the savings are to total EUR 6.3 bn per year.
[16] Dahm (2011). Italien lehnt Privatisierung der Wasserwirtschaft ab. Germany Trade and Invest. June 28, 2011.
[17] OECD (2011). Economic Policy Reforms 2011: Going for Growth. Executive Summary. p. 112.
[18] European Commission (2011). Free movement of capital: Commission requests Italy to modify privatisation law over investment restrictions. IP/11/175, February 16, 2011.

services, has been turned into a holding company. While the navigation services segment is to remain in government hands, some 49% of the airport operator Aena Aeropuertos is to be privatised. At its launch in June 2011 the new operating company was simultaneously mandated to sell its majority holdings and licences in the Madrid Barajas and Barcelona El Prat airports. The sale of the licences (for a 20-year period) is supposed to generate (gross) revenues of EUR 5.3 bn.[19] The original October 30 deadline for submissions of offers in the public tender has meanwhile been extended for 3 months. Moreover, the sale of 13 air traffic control towers has been launched. At the outset of 2011 the airport operator was estimated to have an overall value of some EUR 30 bn.

Spain's privatisation plans have recently suffered a setback, though. The disposal of a 30% stake in Spain's popular national lotteries that was resolved in spring 2011 and anticipated to generate EUR 7-8 bn was shelved at the end of September for the time being. The out-going socialist government justified its action mainly by referring to the difficult situation in the financial markets. Together with the postponement of the privatisation of the Madrid and Barcelona airports this means a loss of roughly EUR 13 bn in revenues that had been budgeted for 2011.

Further privatisation potential might be found in the area of the government-operated mining and/or shipbuilding operations. Another main asset still in the public domain in Spain, as in other countries, is the postal system (Sociedad Estatal Correos y Telégrafos). As regards the state-owned railway system, early 2005 saw the splitting of the network operations (railway infrastructure company ADIF) on the one hand from the state-owned passenger and goods transport company (Renfe Operadora) on the other. The sale of parts of Renfe's freight business is in the planning stage.

GR & ES in comparison
% of receipts up to 2010



Source: Privatizationbarometer.net 11

Greece: National budget
% of GDP

Sources: Deutsche Bank, OECD Statistics, AMECO 12

Greece – ambitious plans

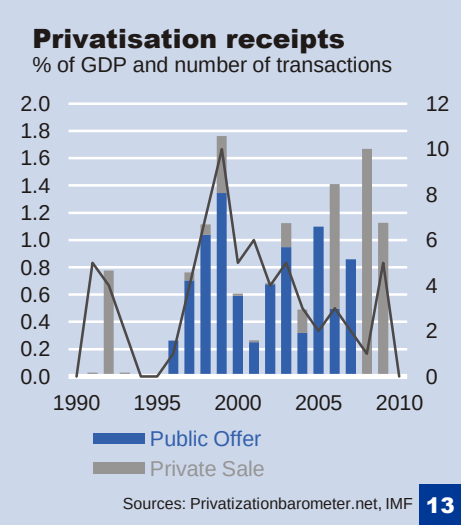
Public companies may be found in the most diverse sectors in Greece. Privatisation programmes got off to a late start – mainly from the mid-1990s. Back then there were already good reasons to take this tack – not only say the higher efficiency of private companies, but also the necessity of fulfilling the convergence criteria of the Maastricht Treaty. The government benefited from direct proceeds totalling well over 1.7% of GDP in 1999. All in all, the Greek government has generated roughly EUR 20 bn via asset disposals over the past few decades.

At present, the Hellenic republic is struggling with the sovereign debt crisis. In return for the aid received from its European partner countries and the International Monetary Fund, Greece has pledged to undertake extensive restructuring measures. They include privatisations meant to generate EUR 50 bn in receipts by 2015[20], or roughly 22% of 2010 GDP. The privatisation process runs via a centralised fund, the Hellenic Republic Asset Development Fund (HRADF), established on July 1, 2011.[21]

[19] Ministry of Territorial Policy and Public Administration of Spain (2011). Autorizada la licitación del 90,05 por 100 del capital de las sociedades concesionarias de los aeropuertos de Madrid-Barajas y Barcelona-El Prat. Press release. July 29, 2011.

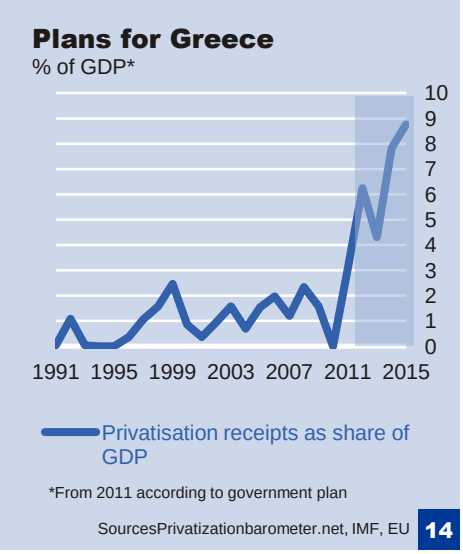
[20] See also the European Commission Plan (2011). The Economic Adjustment Programme for Greece. Fourth Review – Spring 2011. Occasional Papers 82. p. 30ff.

[21] Two representatives appointed by the European Commission and the Eurogroup are entitled to participate in the Fund's Board Meetings as observers.



The fund's biggest source of income is to be the disposal of assets held by KED, the Hellenic Public Real Estate Corporation, worth an estimated EUR 35 bn.[22] The Greek government owns about 70% of the country's land which, depending on the location (and tourism revenues), holds promise of sizeable privatisation receipts. However, broad swathes of the Greek public are staunchly opposed to the disposal of national assets, particularly of Greek land. For this reason there are, inter alia, considerations to offer real estate for lease on a long-term basis instead of selling it outright. Land could be leased for 99 years, for instance, so it would return to government hands afterwards. Another option would be to securitise the assets as fund units that could then be traded.

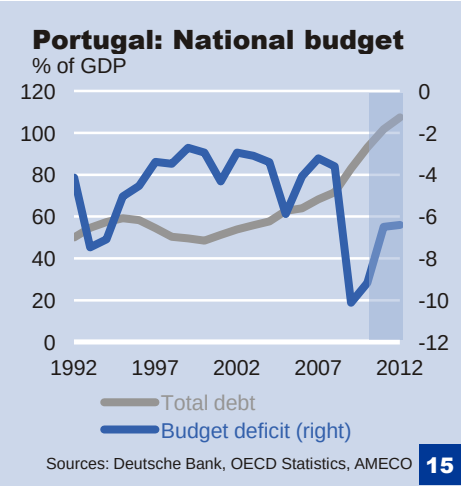
Moreover, the Plan provides for proceeds to be generated from the disposal of listed public-sector companies (EUR 5 bn, market values as of early summer) and non-listed ones (EUR 2 bn, heavily discounted book values),[23] with the companies being restructured in a way that yields the highest income possible. One potential obstacle in this case and in general when state-owned companies are put up for sale is the sometimes large number of employees whose jobs cannot, in principle, be terminated.



Furthermore, Greece has plans to issue licences and rights enabling the private operation of public infrastructure worth an estimated EUR 9 bn. The focus here is on the operation of Greece's two biggest ports, Thessaloniki and Piraeus, as well as the country's motorways. Both shipping and commercial road transport were liberalised back in July 2010. However, serious obstacles threaten the success of these measures. For one, (official) trading in licences for overland transport is still too poorly developed, especially since no new rights have been granted since 1970. Therefore, market entry is no simple matter. A good while ago, the OECD also determined there was a great need for deregulation among the utility companies and called on the government to further simplify the regulatory process for market entry.[24]

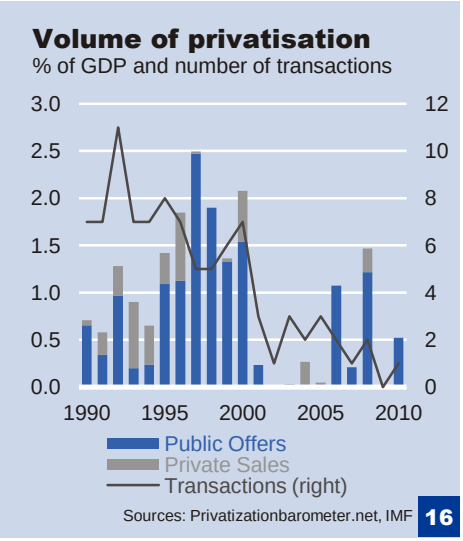
To date, the HRADF has generated revenues totalling EUR 1.8 bn. This is less than the former government's original target of EUR 5 bn, which was later cut to EUR 4 bn due to the difficult situation in the markets.

Portugal – end of golden shares



Portugal is also required to meet conditions pertaining to the restructuring of its budget. Therefore the country has pledged to hike taxes, lower expenditures and implement structural reforms, including privatisations.[25] Some public assets were already privatised back at the end of the 1990s. At the time, the government disposed of various companies and/or stakes and in this way it generated annual proceeds of up to EUR 4.6 bn (1997: 3.5% of GDP). Nonetheless, the sovereign's net new debt only remained slightly below the 3% mark stipulated by the Maastricht Treaty for a few years (1999, 2000 and 2002).

[22] International Monetary Fund (2011). IMF Country Report No. 11/175. July 2011.
[23] In the past, Greece generated nearly 30% of its receipts in the financial and real estate sectors. The contributors mainly comprised various smallish banks. Now, the shares in ATE Bank and Hellenic Postbank are also to be sold. Moreover, OPAP, the national lottery, is also up for debate.
[24] OECD (2011). Economic Policy Reforms: Going for Growth 2011: Country Notes Grecce.
[25] International Monetary Fund (2011). Portugal: Letter of Intent, Memorandum of Economic and Financial Policies, May 17, 2011.

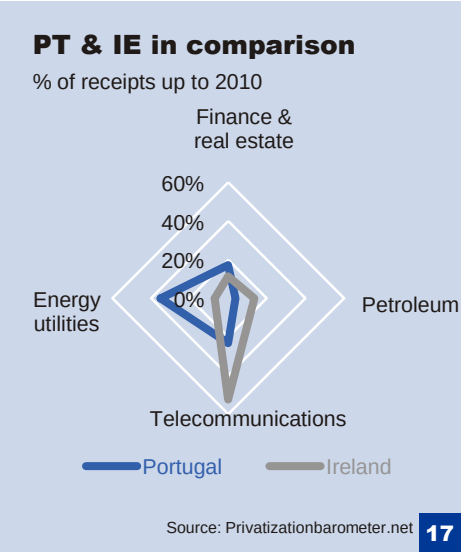


According to the Stability and Growth Programme tabled by the Portuguese government, the receipts currently anticipated from the privatisation activities will total EUR 6.47 bn by 2013, corresponding to about 4% of current debt[26] or 3.7% of GDP.

To encourage the privatisation process and competition in the corporate sector Portugal has already reduced its influence on public-sector companies. For example, the special rights (golden shares) which the government held in some of the companies in its portfolio were abolished. Moreover, it was set out in law that such special rights would never be created again. One of the relevant companies is Portugal Telecom. The government's veto right in the case of disposals has been abolished.

The privatisation projects themselves cover a swath of companies from various sectors ranging from banks and energy utilities through to aviation and the water supply. In the financial sector, the government sold BPN – Banco Portugués de Negocios (nationalised in 2008 during the financial market crisis) – after having previously expended a considerable amount on its restructuring – for EUR 40 m in August 2011. There are also plans to dispose of the insurance activities and the "non-strategic sectors" of another bank, CGD.

The government says that as a rule it wants to dispose of its holdings at a gradual pace. However, a full-scale exit is envisioned in the near term for several major companies. This holds above all for key stakes in the energy sector and the aviation industry. By year-end or in January, the bulk (roughly 21% of the total shares) of the 25% stake (as at September 1, 2011) in energy utility EDP (Energias de Portugal) is to be sold. To make the purchase more attractive for investors, the ownership ceiling for shareholders will be uniformly raised to a maximum of 20% (hitherto 5% except for the government, to which no restriction applied). Galp Energia, another energy utility in which the government indirectly holds a smaller stake, is also shortlisted for near-term disposal.[27] Moreover, Portugal's REN power grid is to be operated as a fully private entity from February 2012 at the latest.



In the air transport sector, the government has initiated its full separation from the airline TAP Portugal, even though the deal – contrary to the original plans – will probably not be closed until sometime in 2012. Airport operator ANA is also to be fully privatised in 2013 and in future will have to compete in a deregulated market with other players.

In addition, the government has announced plans for the next few years that include, among other things, the disposal or partial privatisation of the TV broadcaster RTP, postal service (Correios de Portugal), railway freight company CP Carga and water utility Aguas de Portugal. Especially the last item mentioned merits attention, since in many countries this sector still belongs to the public sector. Furthermore, consideration is being given to the privatisation of some railways and roads.

The privatisations in the infrastructure segment in particular are linked with the efforts to boost overall economic performance, not only of the business sector but especially of the public sector in general. Up to now, many state-owned companies and facilities

[26] Portuguese Ministry of Finance and Public Administration (2011). Programa de Estabilidade e Crescimento 2011-2014. March 2011.
[27] The government still holds 7% via a convertible bond plus 1% via Caixa Geral de Depósitos (CGD).

have operated at a loss, in some cases deep in the red. In the course of their privatisation, necessary restructuring and modernisation measures could be taken. The OECD has also pointed to the need for Portugal to reform its infrastructure.

Ireland – reprivatisation

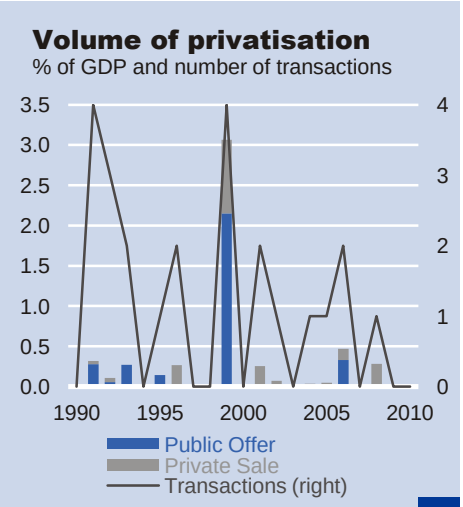
Following a long phase of dynamic growth, Ireland suffered severe blows from the financial crisis as of 2007, partly because of its comparatively large banking sector. Insolvent banks had to be nationalised,[28] so the level of government debt rose sharply. For this reason, Ireland had to seek aid from the EFSF bailout fund and in return commit, inter alia, to restructure its banking sector and lower its budget deficit. Net new debt is to be slashed from 12% of GDP in 2010 to below 3% in 2015.[29]

Budget deficit in 2010 incl. expenditure for nationalisation of banks

Sources: Deutsche Bank, OECD Statistics, AMECO **18**

In the 1990s the Irish government had already registered relatively substantial sums on asset sales. The full disposal of Telecom Eireann (Eircom) in 1999 alone generated EUR 6.3 bn. This corresponded to roughly 4.3% of GDP and resulted in a budget surplus of 2.6% of GDP in that year, and no less than 4.8% in 2000. The trend lost momentum in the subsequent years, however. Currently, the energy sector, airports and seaports, much of the transport sector and the water sector are still entirely or largely in the public domain.

In light of the ongoing crisis the government set up an expert group in 2010 to analyse the country's assets (*Review Group on State Assets and Liabilities).* This past April, the Group tabled its recommendations for better regulation and (partial) privatisation of public-sector activities.[30] The report analyses 16 state-owned companies from the above-mentioned sectors, of which the majority could be at least partially privatised. The experts say the potential proceeds could total some EUR 5 bn (or 3.2% of GDP). The Group is not interested in maximum revenue generation, mainly focusing instead on competition aspects. It recommends that the dominant state-owned companies in the energy sector be unbundled. The transmission networks are to be consolidated shortly under the umbrella of state-owned Bord Gáis Éireann, while production (power generation) and distribution are to be (further) privatised. Airports and seaports are to be restructured and disposed of, if possible. According to the experts, companies such as the postal service (An Post) are not (yet) ripe for privatisation.



Sources: Privatizationbarometer.net, IMF **19**

Set against the recommendations, the government's concrete plans seem more modest – at least for now. It has, for example, announced the sale of a minority stake in the Electricity Supply Board (ESB). It also indicated the possible sale of its remaining stake of just over 25% in Aer Lingus.

To improve the health of the government budget, the National Pension Reserve Fund already disposed of assets worth EUR 10 bn in H1 2011. Of course, this cuts both ways, since the measure reduces the sustainability of pension funding.

To meet the conditions imposed, the banking sector will also be restructured. Following the nationalisation of the Bank of Ireland

[28] Bank of Ireland, Anglo Irish Bank, INBS and Allied Irish Banks had to be nationalised.

[29] International Monetary Fund (2011). Country Report Ireland. No. 11/109. p. 3. May 2011.

[30] Irish government, Department of Finance (2011). Report of the Review Group on State Assets and Liabilities. http://www.finance.gov.ie/documents/publications/reports/2011/revgrpstatassets.pdf

during the financial crisis it was subsequently largely returned to the private sector. At the end of July 2011 more than two-thirds of that bank's shares were in private hands.[31] And the merging of Anglo Irish Bank with INBS is considered one step on the road to eventually returning these two likewise nationalised banks to the private sector.

Conclusion

Even though the topic has been on the economic policy agenda for at least twenty years there is still considerable privatisation potential in a number of EU countries. This holds for say the large countries such as France, Italy and Spain. Each of them probably has state-owned companies and/or holdings (barring the real estate sector) worth roughly 5% of GDP that could be disposed of in the medium term.

In the smaller peripheral countries, expert opinions and/or government plans suggest that the privatisation potential (outside the real estate sector) runs between a good 3% in Ireland and over 6½% in Greece. Of course, these are inclined in principle to be conservative estimates, particularly with regard to potential in the infrastructure segment, for example.

There is scope for privatisation in nearly all sectors of the economy. However, the government is still particularly heavily involved largely in the areas of infrastructure and services of general interest. Rail transport, postal service, water supply and sewage disposal are still in the remit of the public sector in many countries.

Similarly, the public sector still has extensive holdings of real estate. However, there is substantial public opposition precisely to the disposal of government buildings, land and/or woodland (accusations of "selling the family silver").

A sizeable part of the potential is at the municipal level. As the municipalities are more or less autonomous, this is a spanner in the works of far-reaching privatisation initiatives.

The inclusion of international organisations can ensure a greater degree of rigour and consistency in national initiatives. This is all the more important as privatisations are often predicated on initially unpopular decisions and sometimes only show positive effects in the medium to long term.

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Henrike Steimer (henrike.steimer@gmail.com)

[31] Ireland: Department of Finance (2011). Bank of Ireland Capital Investment. Press release. July 25, 2011. To be precise: 68%.

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