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The Privatisation of Public Assets as an Economic Policy Instrument: Private versus Public Ownership of Companies – Theoretical Foundations

In a market economy competition is unthinkable without private enterprise. It is fostered by the privatisation of public assets and can drive innovation, employment and economic growth. In a market economy private companies are the rule, state-owned companies, by contrast, are an exception requiring justification. According to economic theory government intervention (in the form of public ownership of companies) is only justified in a market economy, if there is market failure and the specific government intervention can actually eliminate this market failure.

This study is conceived as a series of three articles to be published in WIFO's Austrian Economic Quarterly in autumn 2011. This first article focuses on the theoretical foundations and mutual relations of public and private ownership of companies, whereas the second article (forthcoming in issue 4/2011) discusses the empirical evidence as well as the extent to which the government can withdraw and the third and final article (forthcoming in issue 1/2012) is dedicated to the practical implementation of privatisation projects and economic policy conclusions. • The author is thankful to Gunther Tichy for useful and constructive comments. The data were processed and analysed with the assistance of Elisabeth Neppl-Oswald • **E-mail adresses: Michael.Boeheim@wifo.ac.at, Elisabeth.Neppl-Oswald@wifo.ac.at**

Background

In spring 2010 WIFO presented a study on the "Consolidation of Government Budgets" ("Konsolidierung der öffentlichen Haushalte", *Aiginger et al.,* 2010), which, inter alia, discusses privatisations as a contribution to a revenue-based consolidation (*Böheim – Handler – Schratzenstaller,* 2010). For selected companies, which are (at least partly) owned by the government, a privatisation potential of between € 7.5 billion and € 25.5 billion was estimated depending on the scope of the privatisation and the discount factor (Table 1).

Privatisation potential

A study by *Alt et al.* (2010), which – in terms of core contents and methodology – is a prompt update of *Aiginger et al.* (2010), focussing on privatisations via the stock market, derives similar amounts. The privatisation potential which can be placed in the stock market either via initial public offerings (IPO) or via secondary public offerings (SPO) is estimated at between € 6.5 billion and € 24.1 billion (Table 2)[1].

Privatisation and the conflicting priorities of economics and politics

Since the publication of the WIFO study, these (relatively) large amounts have repeatedly been reported in the media and discussed in public. The response has shown that "competition", "liberalisation" and "privatisation" are (still) strongly emotive words in Austria's economic policy discussion. The public debate is characterised less by an argument based on economic facts, but rather by the clash of (seemingly) incompatible ideological positions and their knee-jerk and (often) unreflective reiteration. This background and some unexplained incidents during past privatisation projects impede a fact-based economic policy debate in Austria.

[1] The portfolios of companies differ only slightly between the two studies: whereas power suppliers and the Federal Real Estate Corporation (Bundesimmobiliengesellschaft) are taken into account in both studies, *Alt et al.* (2010), unlike *Aiginger et al.* (2010), also look at the airports of Graz, Innsbruck, Klagenfurt, Linz, Salzburg and Vienna as well as the Münze Österreich, though excluding the Austrian Forest Corporation (Österreichische Bundesforste).

Calculation of the privatisation potential

A quantification of the privatisation proceeds that can actually be achieved requires a separate valuation of each individual company. The estimations of *Aiginger et al.* (2010; Table 1) and *Alt et al.* (2010; Table 2) are benchmarks that serve as reference points. They are based on the following assumptions:

Both studies estimate the net present value of unlisted companies (as a permanent rent, $NPV = CF/i$, from the average cash flow CF) by means of the method of discounted cash flows (MDCF). This method offers the advantage that the interest rate i is the only parameter for which an assumption has to be made. As no information on risk-adequate interest rates was available, the studies calculated two alternative variants: Variant 1 applies a low interest rate of 5 percent and Variant 2 applies a high interest rate of 10 percent. The estimated net present values should be interpreted as rough benchmarks, as the uncertainty with respect both to the cash-flow forecast and the risk-adequate interest rate is considerable.

The net present values of the listed companies (the Oil and Gas Corporation, OMV AG, Telekom Austria AG, the Austrian Post and the power suppliers Verbund AG and EVN AG) are calculated on the basis of the current stock price and the number of shares issued (as of October 2009) by *Aiginger et al.* (2010), whereas *Alt et al.* (2010) also apply the MDCF here. Differences between the results of the two studies are also due to different estimation periods and data sources.

Table 1: Privatisation potential estimated by Aiginger et al. (2010)

	Minimum[1] (i = 10 percent p.a.)	Maximum[2] (i = 5 percent p.a.)
	€ million	
OMV AG	516.0	516.0
Telekom Austria AG	178.7	178.7
Austrian Post	364.9	364.9
Power suppliers[3]	3,232.8	14,442.4
Federal Real Estate Corporation (BIG)	1,165.5	3,496.6
Austrian Forest Corporation (ÖBf)	2,136.8	6,410.3
Total	7,594.7	25,408.9

Source: *Aiginger et al.* (2010). i . . . interest rate. – [1] The government retains a 25 percent share in OMV AG, Telekom Austria AG and the Austrian Post, a 50 percent share in the power supply companies as well as a 75 percent share in BIG und ÖBf. – [2] The government reduces its share in all companies to the blocking minority (25 percent). – [3] BEWAG, Energie AG Oberösterreich, ESTAG, EVN, Kelag, Salzburg AG, TIWAG, Verbund, Vorarlberger Illwerke, Wien Energie.

Table 2: Privatisation potential estimated by Alt et al. (2010)

	Minimum[1] (i = 10 percent p.a.)	Maximum[2] (i = 5 percent p.a.)
	€ million	
OMV AG	516.8	516.8
Telekom Austria AG	155.3	155.3
Austrian Post	395.0	395.0
Vienna International Airport	472.5	472.5
Verbund	0.0	2,163.6
EVN	0.0	531.5
Other power suppliers[3]	3,883.2	13,925.2
Federal Real Estate Corporation (BIG)	768.5	4,610.8
Münze Österreich	146.2	876.9
Other airports[4]	223.1	446.3
Total	6,560.6	24,093.9

Source: *Alt et al.* (2010), calculations of WIFO. i . . . interest rate. – [1] The government retains a 25 percent share in the OMV AG, Telekom Austria AG, the Austrian Post and the airports, a 50 percent share in the power supply companies as well as a 75 percent share in the Federal Real Estate Corporation (BIG) and the Münze Österreich. – [2] The government reduces its share in all companies to the blocking minority (25 percent). – [3] BEWAG, Energie AG Oberösterreich, ESTAG, Kelag, Salzburg AG, TIWAG, Vorarlberger Illwerke, Wien Energie. – [4] Graz, Innsbruck, Klagenfurt, Linz and Salzburg.

Already in the government programme for the (prematurely terminated) XXIIIrd legislation period (*Bundeskanzleramt,* 2006) and also in the current government pro-

gramme for the XXIVth legislation period (*Bundeskanzleramt,* 2008) the "privatisation of public assets" is no longer mentioned. With the exception of the "emergency" privatisation in 2009 of Austrian Airlines, which was saved from bankruptcy only by means of government grants, there are currently no privatisation initiatives of the Austrian federal government. The reported refocusing of the Austrian Industrial Holding Corporation (Österreichische Industrieholding AG, ÖIAG) as asset managing institution and risk capital fund is equivalent to a departure from its core function as a "privatisation agency" and can be interpreted as an adjustment to a policy environment that takes no interest in privatisation.

Motivation and research interest

With this series of articles WIFO aims to contribute to a more fact-based economic policy debate on the "privatisation of public assets", as it analyses objectively not only the advantages and opportunities of privatisations, but also their disadvantages and problems. The analysis is based on the theoretical literature and the empirical evidence and intends to present as balanced a view as possible.

As comprehensive and up-to-date empirical studies on the privatisation potential in Austria already exist (*Aiginger et al.,* 2010, *Alt et al.,* 2010), this article focuses on the foundations of and prerequisites for efficient privatisations, which are accepted by a maximum number of stakeholders. It thus aims to close the gap between economic theory, empirical evidence and the practical implementation for economic policy makers.

Insufficient competition as a bottleneck to growth

According to economic theory competition ensures the efficient allocation of scarce resources in a market economy by providing incentives for the implementation of an efficient organisation of the production of goods and services as well as product and process innovation. An increasing intensity of competition can result not only in efficiency gains, but also in incentives to enhance innovation efforts. Based on the assumption of an indirect effect of innovations, the intensity of competition is an important factor for growth and employment: competition forces companies to innovate, innovations, in turn, lead to economic growth (*Ederer – Janger,* 2010, *Böheim – Friesenbichler – Sieber,* 2006).

Innovation and competition as growth engines

The empirical literature confirms a (close) positive relationship between the intensities of competition and innovation up to a very high intensity of competition (*Aghion et al.,* 2005, *Crespi – Patel,* 2008). Via the channel of impact from innovation intensity to growth, which is very well-documented empirically (*OECD,* 2007), viable competition can thus have a beneficial effect on macroeconomic trends. In the long term a combination of innovation activities and enhanced competition seems a promising double strategy to improve competitiveness and to spur growth of an economy (*Aiginger,* 2008)[2].

The growth strategy of enhanced competition

Particularly in an era of budget consolidation, strengthening competition is an attractive economic policy option to spur growth and employment in Austria, as its implementation requires comparatively little government spending (*Aiginger et al.,* 2010). Numerous problems could be solved in a "budget-friendly" way by changing existing regulations.

In Austria, insufficient competition has been identified as a bottleneck to growth both in particular service and intermediate product sectors (e.g., energy supply[3],

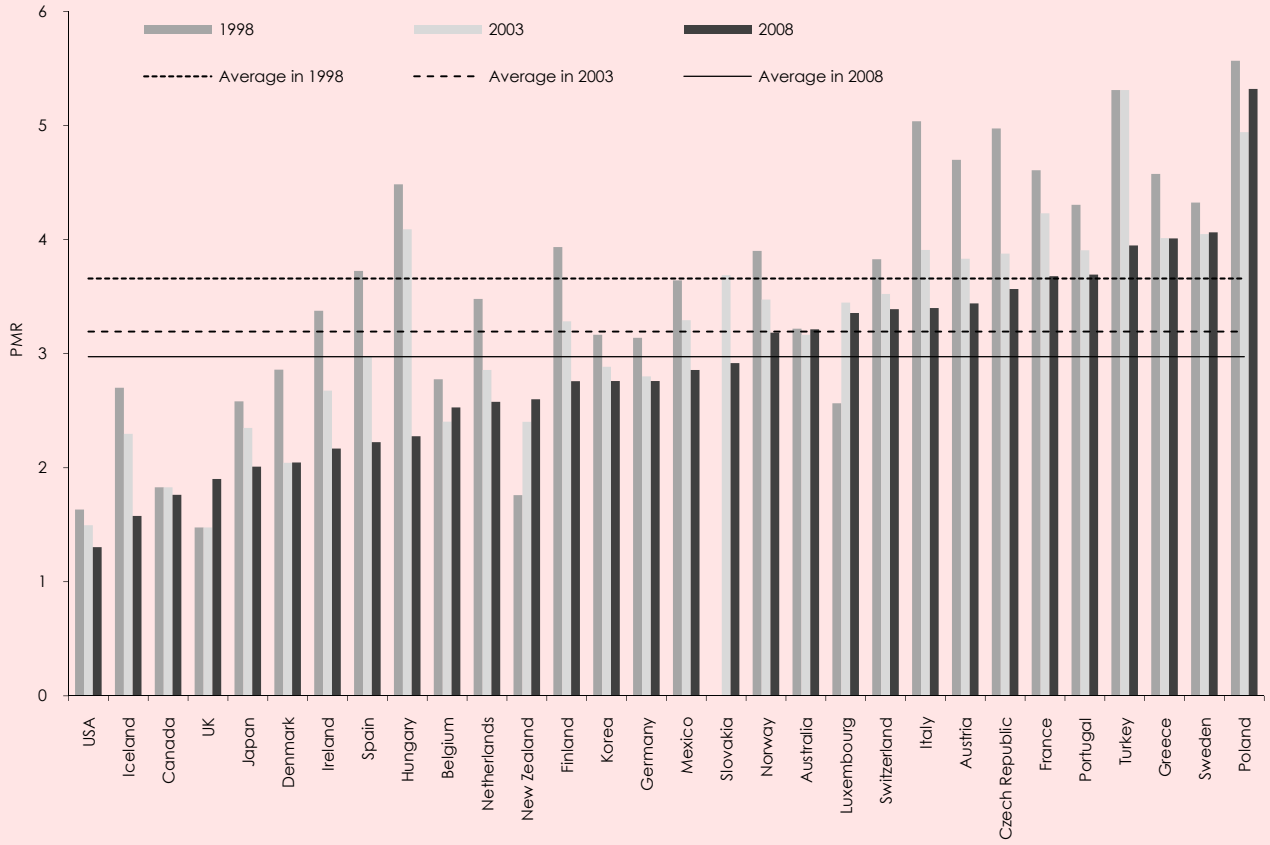
[2] The Scandinavian countries have been particularly successful in applying this double strategy: their economic success is explained not only by the well-known focus on investment to spur long-term economic development (research, technology, innovations and education), but also by their orientation towards competition, which has hardly been acknowledged by the public. As the Scandinavian example shows, a large public sector with an extensive social security system and a strict competition regime do not necessarily contradict each other, but may be excellent complements.

[3] Even more than ten years after the liberalisation no functioning competition has evolved in the Austrian energy market, as the liberalisation was not combined with strict regulation and a competition authority with sufficient clout. *Böheim* (2005) provides an overview of the existing impediments to competition, which can essentially be traced back to persistent conflicts of interest resulting from the state's multiple roles as legislator, owner as well as regulator and supervisor. Suggestions for a solution can be found in *Böheim* (2008). *VKI*

professional services[4], banks and insurance companies, craft and trade, real estate and residential property management, public transport) as well as individual manufacturing industries (e.g., limited local competition in the cement and brick industry). Furthermore, the pace of new business formation, which is slow by international standards, particularly with regard to innovative companies, retards economic growth, because an enhancement of competition by new market entrants that remain present in the long run is lacking (*Ederer – Janger,* 2010).

In addition to shortcomings of general competition policy and to subsidies, which are (excessively) high by international standards, the clearly above average size of the public business sector has been identified as an important bottleneck to growth in Austria (*Böheim,* 2010).

Figure 1: Size of the public business sector by international comparison



Source: OECD Indicators of Product Market Regulation (PMR), WIFO representation. The PMR indicator measures the intensity of regulation: 0 . . . low, 6 . . . high.

Although the privatisation of federally-owned companies between 1998 and 2008 reduced the state share in the business sector substantially, numerous Austrian companies are still owned by all levels of government (federal government, Länder, lo-

(2010) provides an up-to-date overview of the shortcomings concerning switching incentives and the provision of information.

[4] Within the professional services the intensity of regulations that impede competition varies considerably (*Paterson – Fink – Ogus,* 2003). Regulations that are particularly harmful for free-market competition can be found in the fields of pharmacies (economic needs test, the prohibition of ownership by anyone who is not a pharmacist, a ban on mail order selling, strict restriction of prescription-free pharmaceuticals to pharmacies) and notaries public (the reservation of services for notaries, economic planning of a limited number notary public positions).

cal municipalities, Figure 1)[5]. Recent studies (*Aiginger et al.,* 2010, *Alt et al.,* 2010) estimate the privatisation potential at a corresponding level.

As Sweden's positive experience with the ongoing privatisation since the mid-1990s shows (*Jonung – Kiander – Vartia,* 2008, *OECD,* 2008), even a partial materialisation of this privatisation potential would lead to expect major effects on market efficiency in addition to substantial one-off contributions to budget consolidation.

Privatisation as driver of competition and growth

Well-functioning competition resulting in the described positive effects on innovation and growth requires companies to enjoy full economic freedom (within the framework of the legal system). Therefore, private ownership (of means of production) constitutes the rule, government ownership, by contrast, is an exception requiring justification. Private ownership is a sine qua non for competition. The latter is enhanced by the privatisation of public assets, which, via the cause-effect-relationships described above, acts as a driver of innovation and economic growth.

The advantages of private enterprise can be explained by a fundamental theorem of welfare economics, according to which (under certain conditions) an equilibrium in a competitive market is Pareto optimal. No alternative allocation of resources would thus improve the position of one agent without worsening that of another. The assumptions for this definition of an equilibrium are very restrictive and take account only of economic or monetary efficiency goals, paying no attention to externalities of production and consumption, public goods, imperfect competition (the market structure is not expected to be highly concentrated either on the supply or the demand side) and the cost of information and transactions. Thus, government interventions based on efficiency considerations can either be justified by the existence of market failure or by the contention that at least one of the assumptions is violated in reality. Furthermore, the government intervention must be suitable to actually eliminate the market failure by increasing the efficiency of resource allocation and avoiding government failure (i.e., even less efficient resource allocation, *Megginson,* 2005). Hence, government intervention is only justified if there is market failure *and* the concrete government intervention can eliminate the market failure.

The assumptions for the (theoretical) competitive market equilibrium are very strict and hardly ever satisfied in reality. Thus, the theoretical justification of government interventions on grounds of efficiency considerations or market failure is correspondingly easy. However, proving that a government intervention can actually eliminate the market failure (and will not actually worsen the sub-optimal market solution) is much more sophisticated.

A sharp line has to be drawn between the legitimacy and the efficiency of public ownership. The former is a political issue and cannot be assessed on economic grounds, whereas the latter can be evaluated using methods of empirical economic research. In the process of political decision making, legitimacy can be justified on efficiency grounds, but inefficient public assets can – for other reasons – be desired politically and thus be legitimate. However, in the political debate the latter is rarely admitted. Rather, the usual argument given is that "public ownership is at least not more inefficient than private ownership" (or vice versa). This implicit deduction from political legitimacy to economic efficiency, however, would have to be substantiated empirically.

The following section deals with the theoretical arguments for and against public ownership of companies in detail (*Megginson,* 2005)[6].

[5] The available OECD Product Market Regulation Indicators (PMR, as of 2008) already take account of the sale of government shares in companies during the recent past (carried out by the Austrian Industrial Holding Corporation, ÖIAG, since 2004: sale of 17 percent of Telekom Austria AG; complete privatisation of VA Tech and Voestalpine AG, sale of 49 percent of the Austrian Post), excluding, however, the sale of the remaining government share of 41.56 percent in Austrian Airlines to Lufthansa in 2009 as well as the "emergency nationalisations" of Kommunalkredit Bank and Hypo Group Alpe Adria. The latter would have raised the PMR.

[6] The second article in this series of articles focuses on the empirical evidence (Austrian Economic Quarterly, 4/2011).

Public versus private ownership of companies: economic theory

Theoretical arguments in favour of public ownership

There are essentially three strands of arguments to justify public ownership of companies:

- Public ownership can ensure that, besides profit maximisation, companies also pursue social objectives.
- Public ownership of companies can be justified as a reaction to market failure.
- Finally, public ownership of companies can remedy the effects of asymmetric information and incomplete contracts.

For all three lines of argument the efficiency of government interventions rests on the assumption that "benevolent" government agents exclusively pursue public interests. In reality, however, vested interests of the political agents or particular interest groups also always play a role.

The pursuit of social objectives besides profit maximisation

Public ownership of companies can be seen as an instrument to pursue objectives other than purely economic ones. Non-economic objectives that the general public has an interest in can take many forms. Private companies would pursue them only, if this spurred profits. "Popular" objectives of this kind are e.g., the employment of disadvantaged groups of workers, the payment of salaries exceeding the level agreed by the social partners, job creation in peripheral regions, the sale of goods and services at a price below the market price to ensure that they are available to a large share of the population. Via state-owned enterprises these objectives can be pursued irrespective of efficiency considerations. Any necessary cover of losses is borne by the government.

If non-economic objectives are pursued, a prerequisite for the superiority of public ownership consists in an effective, democratically legitimated policy control, which, in practice, is difficult to accomplish on a permanent basis (*Vickers – Yarrow,* 1988). Ambiguous objectives (several objectives) as well as vested interests of supervisory bodies (political parties, but also "assigned" public sector employees) are reflected in an information advantage of management, which, in general, exceeds that over private shareholders.

The dissatisfaction with the performance of state-owned enterprises is often due to the imperfection of political markets rather than inherent weaknesses of public ownership (*Yarrow,* 1986). Further, viable competition is seen as a more important factor for achieving operational and allocative efficiency than the type of ownership (*Kay – Thompson,* 1986, *Cook – Kirkpatrick,* 1988, *Shapiro – Willig,* 1990).

The reaction to market failure

In reality the theoretical assumptions of the perfect competition model (almost) never apply. Correspondingly, there is a wide variety of possibilities of market failure. Natural monopolies, external effects, information asymmetries and public goods are the best-known instances of market failure as opposed to the theoretical model's ideal conditions or of an inefficient allocation of resources.

In case of market failure government interventions can increase efficiency. Public ownership is one possible form of government intervention, which is applied mainly in connection with natural monopolies, information asymmetries and public goods.

Natural monopolies, as e.g., in network industries (energy supply, telecommunications, water supply, etc.), are characterised by a situation, where, due to (increasing) economies of scale, a good is provided efficiently by (only) one supplier and, therefore, a competitive market with several rivalling suppliers cannot develop. Owing to their profit maximising interests, private suppliers have an incentive to limit the supply and raise the price. This is efficient from a micro-economic perspective, but inefficient macro-economically. As state-owned enterprises are not forced to maximise profits, the government as the owner of a "natural monopoly" can provide the macro-economically optimal supply of a good at "socially acceptable" prices. If the politically desired "socially acceptable" prices fail to cover the production cost, the public budget has to provide the funds to cover any losses. In this case the users of the good (private households) are subsidised by the general public (tax payers). Arguing in favour of a cover of losses from the general budget will be the easier the more consumers and tax payers overlap. A prerequisite for a macro-economically efficient supply is that the government as the owner does not pursue its own inter-

ests, such as drawing high dividends from its share in the company or privileging certain interest groups at the expense of the general public ("clientelism"). Rather, the benefit for the consumers must be the main focus.

Modern industrial economics generally prefers government regulation of natural monopolies (keeping private ownership) to public ownership of companies (*Borrmann – Finsinger,* 1999). Supporters of public ownership of network infrastructure argue that the regulation of private natural monopolies remains ineffective due to information asymmetries and regulatory capture. Advanced economic models of regulation, such as e.g., "incentive regulation", aim to solve these problems by transcending a static regulation approach and taking dynamic aspects into account.

In the regulatory practice the decision between public ownership and regulated private ownership of network infrastructure will therefore have to be differentiated depending on the concrete type of network infrastructure. The closer the natural monopoly is to the basic supply infrastructure and the more pronounced the public interest, the easier it is to argue in favour of public ownership.

If at all, public ownership of companies can only be justified in the case of natural monopolies. Independent of the approach – public ownership of natural monopolies or government regulation of private natural monopolies – an accurate demarcation between the natural monopoly and the competitive areas is a key challenge. In the network industries only the network itself is usually a natural monopoly: in energy supply this refers to transmission and distribution networks, in telecommunications this refers to the mobile phone networks and to landlines, in rail transport it refers to the rail network. By contrast, the production and sale of the service itself (electricity, gas, telephony and rail transport) are fields that do not require any government intervention and can be organised most efficiently as private business.

Information asymmetries and incomplete contracts

Concerning the state and progress of a company, management always has an information advantage over shareholders, because it is (necessarily) closer to the company's daily business. Due to insufficient incentives, management will not pass this advantage on to the shareholders (at no cost). Therefore, in an extreme case even regulation will fail, explaining why public ownership is recommended only as "ultima ratio". However, information asymmetries between shareholders and the management they are engaging exist in the form of principal-agent-problems irrespective whether the particular company is privately or publicly owned. Yet, these problems tend to be more pronounced in state-owned enterprises than in private ones.

Similar problems result when it is impossible to conclude all-encompassing contracts specifying the rights and obligations of the counterparties for all possible scenarios. Incomplete contracts can constitute a case for public ownership, if government interventions are justified by market failure or an information advantage of management or if there is a guarantee that the management of the state-owned enterprise is subject to efficient political control (*Shapiro – Willig,* 1990). A disadvantage of regulated private business consists in the fact that the management is accountable to the shareholders and to the regulator, whereas it only answers to the government (as shareholder) in a state-owned company. However, if the government pursues several objectives, similar conflicts may arise.

In the case of incomplete contracts a "mixed" private-public ownership may be optimal, as it overcomes the shortcomings of public ownership (lack of incentives for the improvement of quality) and private ownership (excessive incentives for cost-cutting; *Schmitz,* 2000).

Theoretical arguments against public enterprise

Based on efficiency considerations there are four arguments against public enterprise, of which three include the (controversial) assumption of "benevolent" government agents:

- As the management of state-owned enterprises receives weaker or worse incentives to maximise profits, cost cutting opportunities are not fully made use of. The companies work inefficiently.

- State-owned enterprises are subject to a less strict supervision, because no individually identifiable owners bear the economic risk of entrepreneurship, but rather the anonymous public sector as a collective owner.
- It is (practically) impossible for a state-owned enterprise to be subjected to bankruptcy proceedings (in time), if the politically responsible persons have failed.
- If one drops the assumption of "benevolent" political actors, it is possible that the organisation of state-owned enterprises is mainly influenced by the interests of political parties or interest groups close to them instead of economic considerations and concern for the general public.

Wrong incentives

Irrespective of the principal-agent-problems mentioned above, incentives for the management of (privately owned) profit-oriented companies are easy to design by giving the management a share in the profits of shareholders. As a consequence, the incentive to manage a company efficiently as well as to invest into an optimisation of its cost position and to reduce x-inefficiency will be substantial.

Incentives to cut costs, to improve quality and to innovate, which are induced by market competition, are the most important drivers of business growth (*Hayek,* 1944, *Shleifer,* 1998, *Böheim – Friesenbichler – Sieber,* 2006). In this respect, the management of state-owned enterprises, which, in line with the intentions of policy makers (representing the owner), pursues other objectives than profit maximisation, clearly has weaker incentives. In addition to the interests of the shareholder, it has to balance a large number of diverging interests (*Dixit,* 1997). Being public sector employees, managers will, on rational grounds, abstain particularly from proactively pushing efficiency increases, because, on the one hand, they are not sharing the full gains, but, on the other hand, they have to bear the main cost burden (employees', customers' and suppliers' protests). Incentives for the management of publicly owned (natural) monopolies are particularly weak, because consumers do not have any alternative and the lack of competition perpetuates inefficiencies (*Shleifer,* 1998, *Hart – Shleifer – Vishny,* 1997, *Caves,* 1990).

Insufficient control

State-owned enterprises belong to everyone rather than particular individuals. As a consequence of widely dispersed ownership and information asymmetries, control of the management is much weaker than in private companies (*Alchian,* 1965). Further, the management of state-owned enterprises faces a much smaller risk to be dismissed due to unsatisfactory performance (*Vickers – Yarrow,* 1988), because it is often recruited from a political party or interest group environment. The control of state-owned enterprises by the market (via the transparency of cost and benefit) is significantly less pronounced than that of private companies, where, for this reason, the supervision of the management is far easier (*Vickers – Yarrow,* 1991).

No insolvency risk

Sooner or later private companies that are managed inefficiently will disappear from the market as independent business units. Shareholders will withdraw their funds and transfer them to more profitable investments. In general, state-owned enterprises do not face this threat, because the disciplining function of the capital market is suspended and the management can expect a cover of losses from the government budget.

In practice, large state-owned companies, in particular, prove to be "too big and politically too important to fail" and successfully claim the (unjustified) status of "systemic relevance" (*Böheim,* 2011, *Lions,* 2009). As a consequence, state-owned companies which are inefficient and already insolvent by economic standards are kept alive for too long by the government. Policy makers willingly accept distortions of competition as "collateral damage", the crisis of the Austrian nationalised industrial companies at the end of the 1980s being an impressive piece of empirical evidence. Admittedly, private companies (e.g., Opel in Germany), too, have tried to claim a status of systemic relevance in the current economic crisis. However, they have been much less successful than state-owned companies.

Non-economic objectives

The opportunity to pursue non-economic objectives (apart from profit maximisation) with nationalised companies, which has been invoked above as an argument in favour of public ownership, relies on the existence of "benevolent" government agents who exclusively serve the public interest. If the strong assumption of a decision mak-

ing process that is uninfluenced by vested interests of the agents or particular groups of interest is abandoned, the argument is reversed.

Political agents, who are driven by their own vested interests (the retention of power in particular), will use their positions as representatives of the public shareholder to induce the management of the state-owned enterprises to implement projects that favour the pursuit of these vested interests. In return for their compliance with the expectations of policy makers state-owned enterprises receive other "benefits" that are not available to private companies, such as higher subsidies or protection from competition. However, if the management of a company is no longer able to act exclusively in line with economic criteria, the state-owned company will act less efficiently than a private company, if democratic control does not work properly (*Shleifer – Vishny,* 1994). State-owned companies thus deteriorate into a "gravy train" for politicians, who favour particular parts of the population ("clientelism"), while incurred losses are borne by the general public. Instead of the alleged redistribution in favour of low-income strata of the population, this results in the opposite, i.e., a transfer of funds to privileged groups with strong political links (*Jones,* 1985). The Austrian energy sector is an impressive proof, as low-income energy users paying excessive energy prices also subsidise the incomes of the employees in the state-owned energy sector, which are very high compared to those in other sectors.

The problem of clientelism can only be avoided, if companies are independent of policy makers[7]. The smaller the government share, the more limited the possibilities of intervention. Ultimately, independence from politics is only given for companies in complete private ownership, because even a public "core shareholder" will try to pursue other objectives than purely economic ones (*Shleifer – Vishny,* 1994, *Boyko – Shleifer – Vishny,* 1996).

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[7] Whereas in Austria the listed energy supplier Verbund AG has managed more or less to emancipate from politics, the energy suppliers owned by the Länder as well as the large municipal energy suppliers still face (excessively) strong political influence.

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The Privatisation of Public Assets as an Economic Policy Instrument: Private versus Public Ownership of Companies. Theoretical Foundations – Summary

The positive effect of viable competition on innovation and economic growth is well-documented empirically. Viable competition relies on companies that can freely develop economically. Full economic freedom can only be enjoyed by companies in private ownership. Therefore, private ownership is the rule in a market economy, public ownership, by contrast, is the exception requiring justification. There is no competition without private ownership. The privatisation of public assets fosters competition and can serve as a driver of innovation and economic growth. According to economic theory, government intervention (in the form of state-owned enterprises) is justified in a market economy only, if there is market failure and the particular government intervention can actually eliminate the market failure.

There are basically three strands of arguments to justify state ownership of companies:

- Public ownership can ensure that companies (also) pursue other objectives apart from profit maximisation.
- Public ownership of companies can be justified as a reaction to market failure (e.g., if there are natural monopolies, external effects or public goods).
- Finally, public ownership can help in cases of information asymmetries and incomplete contracts.

On efficiency grounds there are four arguments against public ownership:

- As the management of a state-owned company has weaker or worse incentives to maximise profits, the cost cutting potential is not fully used and the companies operate in an inefficient way.
- State-owned companies are less strictly supervised, because no individually identifiable owner but the "anonymous" public sector as a collective owner bears the entrepreneurial risk.
- It is nearly impossible that state-owned companies are subjected to bankruptcy proceedings (in time), if those who are politically responsible fail.

It is often argued that the concrete design of state-owned companies is mainly determined by the interests of political parties or related interest groups instead of economic considerations as well as concern for the general population.

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