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The Privatisation of Public Assets as an Economic Policy Instrument: Private versus Public Ownership of Companies – the Practical Implementation of Privatisation Projects and Economic Policy

Conclusions

Liberalisation, competition and regulation are the most important economic prerequisites for successful privatisation measures, while acceptance by the population (and its political representatives) is the main political precondition. In competitive markets the success of privatisation measures no longer depends on the economic framework, but on (social and) political conditions. However, if a competitive market does not exist, a government willing to privatise faces the challenge of creating the necessary conditions for well-functioning competition ahead of privatisation and of guaranteeing viable competition subsequently. Besides de-ideologisation and transparency, social and political acceptance also requires the illustration of potential trade-offs.

This study is conceived as a series of three articles published in WIFO's Austrian Economic Quarterly in autumn 2011 and spring 2012. The first article (<http://www.wifo.ac.at/www/pubid/42850>) dealt with the theoretical foundations and mutual relations between private and government ownership of companies, whereas the second part (<http://www.wifo.ac.at/www/pubid/43472>) focused on the empirical evidence and investigated which extent of government withdrawal from state-owned enterprises would be optimal from the perspective of industrial location policy. Finally, this third article is dedicated to the practical implementation of privatisation projects and conclusions for economic policy. • The author is thankful to Gunther Tichy for useful and constructive comments. The data were processed and analysed with the assistance of Elisabeth Neppi-Oswald • E-mail addresses: Michael.Boeheim@wifo.ac.at, Elisabeth.Neppl-Oswald@wifo.ac.at

Privatisation projects begin with the definition of an objective. In practice seven main objectives of privatisations have emerged (*Cavaliere – Scabrosetti, 2008, PricewaterhouseCoopers, 1989*):

- Increase in the efficiency of companies (efficiency maximisation),
- reduction of public debt (maximisation of proceeds),
- strengthening of financial markets,
- reduction of government interference in business,
- entrance of hitherto state-owned companies into competition,
- subjection of state-owned companies to market discipline,
- broadening of the shareholder base.

From an economic point of view the most important objective of a privatisation is the increase of the company's efficiency, because it helps improve the allocation of resources. In particular, governments should resist the temptation to choose a privatisation approach, which maximises the short-term proceeds for the government budget, while boosting efficiency recedes into the background. A privatisation strategy focusing on increases in efficiency will maximise the government's long-term privatisation revenue, i.e., the total of all payments to the government (*Böheim, 2011B*). In the long run, all other objectives will be met as a "collateral benefit" of the increased efficiency without any requirement for further government intervention.

Objectives of privatisation

The literature classifies five different forms under the general term "privatisation" (Aiginger, 1998, Schauer, 1998):

- *Privatisation of assets*: transfer of ownership from the government to a private investor,
- *formal privatisation*: outsourcing of an activity from the public administration into an independent entity that is owned by the government,
- *functional privatisation via competition in the market*: opening of a state monopoly to competition via liberalisation and deregulation¹,
- *functional privatisation via competition for the market*: licensing (outsourcing) of a service deemed desirable by the government to private companies that provide the service by order and for account of the government,
- *organisational privatisation*: implementation of performance elements, demand signals and competition within the public sector.

The following paragraphs focus on the privatisation of assets, i.e., the transfer of ownership from the public sector to private investors (Böheim, 2011A) as well as the conditions and prerequisites for a successful implementation of privatisation projects.

A key prerequisite for the emergence of competition consists in a legal system, which both safeguards private ownership, freedom of acquisition and contract and protects against barriers to competition. Beyond this necessary institutional framework a pronounced spirit of competition² is required. It is defined as the intention to obtain advantages over competitors solely via providing a superior product, as the rejection of any behaviour that impairs competition and, finally, as the acceptance of potential threats to survival in the competitive process.

Further, it must be ensured that the competitive process is constantly stimulated via creative companies finding sufficient incentives for innovation initiatives ("the innovative entrepreneur"; Schumpeter, 1911) on the one hand and via competitors having the possibility to imitate the pioneering product (at lower prices) after an appropriate time period on the other hand³.

Eventually, viable competition can only be safeguarded in the long run, if both market entry and market exit are possible at all times. Barriers to exit prevent the adjustment of supply to a declining demand, as companies do not exit the market. This results in a misallocation of resources, because resources remain bound where they are no longer necessary to feed the market.

In the case of barriers to entry tight oligopolies will emerge sooner or later, i.e., only a few large companies divide the market among themselves. If the number of suppliers declines, the probability of barriers to competition increases disproportionately.

For the case of tight oligopolies game theory allows to infer a substantial danger of collusion that may harm competition (Selten, 1972, Tichy, 2002). This is a situation which provides "fertile ground" for all types of misuse of market power. As Selten (1973) shows on the basis of game theory the danger of collusion does not decline significantly until there are more than five competitors, because, in this situation, an outsider can increase his market share (and profit) by deviating from cartel behaviour (lower prices): thus, in the model the probability of collusion is 100 percent in the case of four or fewer competitors. However, it falls to 22 percent as soon as there

¹ This includes the option of transferring the state-owned monopoly into private ownership (privatisation of assets).

² The more companies are lacking this spirit of competition and the more they are lacking the ability to innovate and adapt, the stronger is their inclination towards barriers to competition and the more there is a necessity of an effective, government competition policy. However, it can be assumed that the latter's chances of success are also correspondingly smaller (Berg, 2002).

³ In the absence of such a possibility (e.g., due to excessively long periods of patent protection), the temporary monopoly of a successful innovator ("Schumpeter monopoly") turns into a permanent monopoly ("Cournot monopoly"). The competitive process comes to a halt.

Forms of privatisation

Competition requirements

are five competitors and it is only 1 percent, if there are more than five competitors. These theoretical considerations have repeatedly been corroborated in empirical studies (Hay – Kelley, 1974, Bresnahan – Reiss, 1991).

By implication this means that, in principle, a competitive market requires the existence of at least five independent market participants (Tichy, 1998).

Liberalisation, competition and regulation are the most important economic pre-conditions for successful privatisations, whereas acceptance by the population (and its political representatives) is the most important political prerequisite.

From a macroeconomic perspective privatisations can be implemented most successfully in competitive markets. Therefore, a general recommendation to privatise can be derived from economic theory for the case of competitive markets. International empirical evidence supports the hypothesis that privatisations in competitive markets enhance efficiency (Böheim, 2011B).

In competitive markets the success of privatisations no longer depends on the economic conditions, but (only) on social and political requirements (see below). If competitive market conditions do not exist, a government willing to privatise faces the challenge to create the necessary conditions for viable competition *ex ante* and to guarantee viable competition *ex post*.

If a market is characterised by barriers to competition, the government has to open the market to competition by liberalising it prior to privatisation and to support the opening of the market by the corresponding regulation so that viable competition can emerge. Only under these conditions privatisations can effect a more efficient allocation of resources than in state-owned monopolies or oligopolies.

Modern regulatory economics, which is based on the theory of "contestable markets"⁴ (Baumol – Panzar – Willig, 1982), provides the theoretical foundations to transfer companies in natural monopolies to private ownership while implementing the corresponding regulatory measures. In economic theory a natural monopoly is defined as a market form, in which supply by a single company is most efficient (Borrmann – Finsinger, 1999).

Modern regulatory economics differentiates the necessity to regulate with respect to the level within the supply chain. This disaggregated approach to regulation (Knieps, 2008) envisages the "unbundling" of the company into various supply chain levels. Depending on the intensity of the interference two types are distinguished: *legal unbundling* merely organises the different supply chain levels in independent corporations which are separate in terms of corporate law but not in terms of ownership, whereas *ownership unbundling* stipulates different owners for the unbundled sub-corporations.

By unbundling vertically integrated monopolies economies of scale and of scope may be lost. This disadvantage must be weighed against the advantage of an increase in efficiency and competition. Disadvantages of regulation also consist in the high cost and the information asymmetries which, in practice, exist between the regulator and the regulated company and impede an optimal implementation of the regulatory strategy. Despite these limitations the combination of regulation and competition has proved the superior option to realise potential efficiency gains in practice.

Only in exceptional cases a state-owned enterprise as a whole will form a natural monopoly. Therefore and in line with the findings of modern regulatory economics the company is, in practice, usually split up into two parts in a first step. These two

⁴ Microeconomic theory defines contestability as the possibility of market entry by a potential competitor. If market entry is easy (i.e., there are few or no barriers to entry), the term "contestable market" is applied. If, due to high barriers to entry, other companies cannot enter the market even if potential profits are high, the market is non-contestable. The contestability of a market is determined by existing barriers to entry, access to sales and procurement markets and adequate technologies as well as the price-setting behaviour of existing suppliers in the market (in the case of a monopoly or an oligopoly).

Liberalisation, competition and regulation

parts consist of one business unit that can operate in a competitive market and one business unit encompassing the natural monopoly. Thus, e.g., in network industries, only the network as such is a natural monopoly, whereas the service provided in the network can be produced in competition. The state regulator has to ensure that all participants have equal access to the network. This equal or undiscriminating market access is a prerequisite for the emergence of competition in the market.

The intensity of regulatory interference depends on the level of sunk costs. In natural monopolies with low sunk costs, e.g., in mail delivery, the operation of bus services or rubbish collection, less intrusive measures than the regulation of market access (e.g., tenders or auctions) can spur competition and thus increase the efficiency of service production.

By contrast, natural monopolies with high sunk costs, as in energy supply (electricity and gas), in telecommunications and in the rail sector, require strong regulatory measures. However, in these industries the natural monopolies are limited to the networks. Thus, e.g., in the electricity and gas sectors merely the grids are natural monopolies with high sunk costs, why only this sphere requires a high regulation intensity. Distribution and trade of energy sources can generally be considered competitive, do not require any regulation according to economic theory and are thus suitable for privatisation from an economic theory point of view. However, this holds only under the condition that competition is actually established in the potentially competitive markets. For this purpose liberalisation and deregulation have to be accompanied and complemented by strict competition policies.

With respect to the optimal form of ownership of an unbundled natural monopoly (network) the government generally faces two options: the natural monopoly can remain in public ownership or be (fully or partly) privatised. In the theoretical case of an optimal regulation of market access there is no difference between a public and a private owner of the natural monopoly (network operator), because regulatory measures can always ensure non-discriminating access for all market participants under competitive conditions as well as the necessary quality and uninterrupted supply at minimal cost.

As, in practice, the theoretically optimal regulatory strategy cannot be implemented in its pure form⁵, it is necessary to verify whether the public interest might justify public ownership of natural monopolies. The government can assert a reasonable public interest in companies providing services of general interest (energy supply, water supply, public transport, mail services etc.) to ensure security of supply (strategic public ownership; *Böheim*, 2011B). In the case of the natural monopolies (network infrastructure), which exist in these industries and are of outstanding strategic importance for the survival of the community and the competitiveness of the economy, the argument holds all the more.

An argument in favour of continued public ownership of natural monopolies is that a non-profit owner will give top priority to the security of supply and ensure high network quality. As the costs of network access are passed through to the customers, network quality could exceed the level which is necessary for supply security while the respective costs are neglected. As a consequence of such inefficient excessive network investments prices are higher than in a regime of efficient regulation and private network operators. By contrast, private natural monopolists will aim at efficient investments, risking underinvestment into the network infrastructure. The decision in favour of private ownership of natural monopolies calls for sophisticated regulation to prevent any misuse of monopoly power by the private owner in the long run and ensure a functioning infrastructure.

De facto there are various solutions to this problem in Austria. In telecommunications the government refrained from an unbundling of the formerly state-owned monop-

⁵ Inter alia due to the information asymmetries between regulator and regulated company mentioned above.

oly (Telekom Austria) and established competition⁶ via the regulation of access to essential facilities. A majority share of Telekom Austria is now owned by the private sector. At 28.42 percent the Republic of Austria, via its stake in the ÖIAG⁷, owns little more than the blocking minority defined by stock corporation law.

In the energy sector the integrated Austrian power supply companies were legally unbundled by transferring network operation and sales into separate limited liability corporations as a consequence of EU pressure in the context of measures to liberalise the energy market. The majority stake of the power supply companies has remained in public ownership. Functioning and sustained competition has not yet emerged in the Austrian energy markets⁸.

The privatisation of unprofitable public companies which, for political reasons⁹, are urged to set prices below cost for their services is a special case (*Alt et al.*, 2010).

A company that sets prices below cost cannot be profitable in the medium and long term and needs government subsidies to survive. Without subsidies the net present value of the company would be negative and no rational investor would purchase the company and continue operating it at a loss under unchanged conditions. Despite the imposed unprofitable business model even such a company can, in principle, be sold to private investors.

Beforehand, the government can define the quality of services, fix the price for the final consumer at the politically desired level and, under these restrictions, sell the company to the investor who offers to provide the service permanently at the lowest one-off subsidy¹⁰. This "best bidder" would have to be determined in an auction.

From the government's perspective a one-off subsidy in the course of the privatisation of the company means a substantial improvement compared to the annual compensation of the loss, because, due to the capped subsidy, the investor has an incentive to provide the services as efficiently as possible. This is counterbalanced by the risk that the (alleged) "best bidder" has miscalculated and cannot meet the contractual obligations in the long run, particularly with respect to required investments, and, as a result, the government will once again have to step in. This problem might be mitigated through insurance.

The following particular privatisation option seems worth considering in the case of large municipal utilities (MUs; *Aiginger et al.*, 2010): private investors can acquire a stake of 25 percent in the capital of the MU, 75 percent remain in municipal ownership. Abroad subsidiaries can be opened with the reverse ownership relations (75 percent private, 25 percent municipal) in order to make the MU's know-how marketable by "exporting" it. This structure would be mutually beneficial ("win-win") without impairing the quality of municipal supply: the municipalities benefit from one-off privatisation proceeds in the short term and via higher dividends from the more dynamic company performance in the long term, while private investors are given access to a potentially lucrative market.

⁶ The fact that viable competition emerged in the Austrian telecommunications markets is largely due to technological change, which has been particularly dynamic in this sector.

⁷ ÖIAG is an acronym for Österreichische Industrieholding AG, a publicly owned corporation managing and privatising public assets.

⁸ Due to a lack of strict regulation and the absence of a competition authority with sufficient power no functioning competition has emerged in the Austrian energy markets even more than ten years after the liberalisation. *Böheim* (2005) provides a detailed overview of the existing barriers to competition, which can essentially be explained by persistent conflicts of interest resulting from the government's multiple roles as legislator, owner as well as regulator and supervisor. Proposals for a solution are given in *Böheim* (2008).

⁹ Among the large number of motivations environmental, health and social considerations dominate in practice.

¹⁰ As a matter of course it has to be ensured that the subsidy is in line with EU competition regulations concerning government financial assistance.

The privatisation of unprofitable public companies

Privatisation of municipal utilities

The privatisation of public assets is a controversial issue (particularly in Austria), which is discussed less from an economic perspective (usefulness) than from a social policy perspective (ideology). To a very large extent the public debate is ideologically charged¹¹. Emotions come to the foreground and fact-based arguments recede to the background. The participants in the discussion are divided into the irreconcilable factions of the "noisy opponents and the quiet proponents" debating past each other. Objective facts are confounded with myths. Under these circumstances it is hardly possible to achieve social and political acceptance of privatisations.

The establishment of social and political acceptance rests on three conditions: a "de-ideologisation", the creation of transparency and the illustration of potential trade-offs.

In Austria, mainly fact-based reasons were relevant for nationalisation (Tichy, 1988). Companies were largely transferred to public ownership as a consequence of bankruptcies as in the case of the railways in the 19th century and the banks in the world economic crisis of the early 20th century. Lack of capital (in addition to the attempt to block the occupying forces' access to former German property) was one of the economic reasons why the nationalisation of a rapidly expanding primary industry was not opposed in Austria during the after-war years. This is complemented by the government operation of natural monopolies, such as the provision of network products and services such as telecommunications, electricity, gas and water supply, waste water disposal, rubbish collection etc.

These motives for the government's engagement as an economic agent (not as a regulator!) were hardly relevant from a social and political or ideological perspective. Political reasons were most likely to play a role, if vital infrastructure was not to be left to private capitalists. Further, the pioneering role of nationalised companies in social policy was lost at the latest during their crisis in the 1980s and is unlikely to be resumed in an open competitive economy.

Meanwhile the main motivations for nationalisation – lack of capital and natural monopolies – are no longer justified in their original form. Concerning the availability of capital the situation has even reversed: currently, unlike in the after-war period, there is not only enough private capital, whereas it is rather public capital that is in short supply. Due to the difficult budget and debt situation it is extremely challenging for the government to allocate financial resources to large investment projects. This argument of an alternative use of public capital also has to be mentioned in the debate of privatisations (see the discussion about possible "trade-offs" below).

With respect to natural monopolies the progress of regulatory instruments has created new economic policy options to establish competitive markets via regulation. In addition, new forms of regulation have been developed which facilitate enhanced competition thus raising efficiency, e.g., competition for the market as a complement to competition in the market or the separation of network and operator. Where competition can be established via regulation there is no economic argument against the withdrawal of the state as operator and owner¹².

The situations of individual types of public utilities have to be differentiated. In some industries technological change has meanwhile eroded natural monopolies rendering public ownership obsolete. This trend has become most obvious in telecommunications, where there is no longer only one state-owned landline network, but parallel "private" networks are operated by other telecommunications companies. Furthermore, mobile phone services have meanwhile become the most challenging competition to traditional landlines, both in voice telephony and data transmission.

Social and political acceptance

"De-ideologisation"

¹¹ The wording is revealing: "Verscherbeln des Familiensilbers" ("flogging off the family silver"), "Ausverkauf" ("clearance sale") etc. are common synonyms for "privatisation" even in reputable Austrian media (e.g., <http://derstandard.at/1295571430750/24-Milliarden-Wiener-Boerse-erhofft-Privatisierungswelle>).

¹² However, the withdrawal from economic activity needs to be counterbalanced by an enhanced regulatory activity of the government in order to ensure viable market competition and the respective supply in the long run.

In grid-bound energy supply (electricity and gas) it is neither economical nor technically feasible to increase the number of networks. Transmission and distribution networks will remain natural monopolies, whereas – assuming the required regulation – energy production and distribution can in principle be provided competitively. Besides competition considerations, public interest in these strategically important infrastructure facilities also provides an argument in favour of continued public ownership of networks (Böheim, 2011B).

Drinking water supply and waste water disposal require very long-term investments into the water mains and the sewage system, so that here there is also a strong argument in favour of continued public ownership of network systems. In principle the privatisation of the water supply and waste water disposal seems possible from a regulatory perspective. However, in this case, too, it is an issue of functionality.

In principle the privatisation of mail services is possible. However, it requires a corresponding regulation of universal services. The railway network remains a natural monopoly. Here, competition among operators has emerged mainly in freight transport, but is expected to intensify also in passenger transport (though probably only on profitable main routes such as the "Westbahn" connecting Vienna, Linz and Salzburg). In theory, the ÖBB's¹³ passenger transport could also be privatised at least in part, if universal services were regulated correspondingly. The government subsidy could be minimised by way of a public tender of the transport services.

If in the past ideological motives hardly played any role in the nationalisation, there is no justification for ideological objections to privatisation. However, in cases where real (economic or technical) problems would persist after the transfer from public into private ownership, there are no grounds for a privatisation "for the sake of privatisation" or "at any cost". If these two elementary insights gained acceptance in the general public, this would be considerable progress towards a more fact-based and less ideological discussion providing the basis for a more relaxed approach towards the topic of "privatisation".

Due to their non-transparent implementation some privatisation processes of the recent past made it to the headlines. This resulted in a massive loss of confidence in the usefulness of privatisation among the general public. In the reporting and public perception the undeniable success stories were drowned out by (alleged) privatisation scandals.

Completely irrespective of a political or legal dimension of this trend, which is not commented on in this article, the corresponding political and economic lessons have to be learnt. The most important lesson to be learnt from these incidents is: uncompromising transparency is the sine qua non for credibility. Only a credible privatisation policy "playing with open cards" will be able to win back the lost confidence of the general public. The objective must be to largely exclude any misuse of public funds beforehand rather than penalise it (if at all) afterwards. For this purpose the whole privatisation project has to meet the highest transparency standards during all phases of the privatisation process.

The OECD (2009) recommends the adherence to the "Guidelines on Best Practice for the Audit of Privatisations" by the International Organisation of Supreme Audit Institutions (INTOSAI), to ensure independent external control during the whole privatisation process (not just in retrospective).

Transparency International's "integrity pact"¹⁴, which has been adapted to the particularities of privatisation projects, could also serve as a frame of reference. The integrity pact is intended to serve as an instrument of prevention and relies on the voluntary commitment of all participants in the process to comply with predefined rules. It pursues two essential objectives:

Transparency

¹³ ÖBB is the acronym for "Österreichische Bundesbahnen", the Austrian federal railway corporation.

¹⁴ http://www.transparency.org/global_priorities/public_contracting/integrity_pacts.

- Businesses should be able to refrain from corruption, because their competitors equally refrain from corruption and the decision makers in public administration, too, pledge to prevent and avoid corruption and to implement a transparent procedure.
- Governments and other administrations should be able to avoid the high damage and costs as well as distortions of competition resulting from corruption.

Under the integrity pact the contracting authority commits itself and its employees to no bribery and equal treatment of all bidders with respect to information about the project. The bidders pledge not to attempt any bribery, not to enter into any agreements with competitors that limit competition and to disclose all payments to consultants and other middlemen. The contracting authority and the contractor also insist on consultants and subcontractors complying with these regulations.

Violations of the integrity pact are subject to clearly defined sanctions: employees of the contracting authority will face disciplinary consequences as well as liabilities under civil and criminal law. The bidding companies face the threat of an annulment or loss of the contract, an obligation to compensate for damages (both to the contracting authority and to competitors) and the long-term debarment from future contracts ("blacklisting").

Monitoring compliance with the integrity pact or the INTOSAI guidelines should be assigned to an independent external institution. In Austria, e.g., the Court of Audit could be considered.

Due to the pronounced public interest (and the negative experience of the past) it is advisable for privatisation projects in any case to drop the voluntariness of the self-commitment and to demand an obligatory self-commitment of all participants in the privatisation process or, alternatively, their debarment. If these strict transparency standards are adhered to, it might be possible to restore the general public's trust in a proper implementation of privatisation projects.

Government assets are not free of opportunity cost: the capital which is tied up in business stakes is not available for other government tasks. If the public interest can be served with a lower capital investment, the economic perspective suggests that public assets exceeding this level should not be retained (*Böheim, 2011B*).

It is the responsibility of policy-makers to define alternative uses which promise a higher macroeconomic return in the long run. From an economic point of view there are basically two sensible strategies:

- Privatisation proceeds can be used to reduce government debt. As Sweden's positive experience with the ongoing privatisation since the mid-1990s has shown (*Jonung – Kiander – Vartia, 2008, OECD, 2008*), the privatisation of public assets can be used for the initial financing of a consolidation of the government budget. On the one hand it serves to generate additional revenues, but on the other hand it also increases the acceptance of spending cuts, as both purely expenditure-based and revenue-based (i.e., via the increase of taxes) budget consolidation will reach natural limits. Due to saved interest payments¹⁵, the realisation of the estimated privatisation potential of € 7.5 billion to € 25 billion would yield an annual budget improvement of between € 300 million and € 1 billion all other things being equal (*Aiginger et al., 2010*).
- Privatisation proceeds could also be used for long-term investments into future development (research, technology, innovation and education). Government investments in these fields promise large positive macroeconomic effects in the long run. Even in a phase of budget consolidation public spending on the promotion of business research and innovation as well as on the education system should be increased further. This is due to the exceptional and undisputed role of innovation and education as investments into future development, which drive growth in advanced economies (*Janger et al., 2010*).

¹⁵ For these estimates an interest rate of 4 percent p.a. has been assumed.

Trade-offs

The effects on growth and employment can be expected to be stronger than in the case of government capital remaining tied up in business stakes, which are not necessary for the protection of the public interest (Böheim, 2011).

Earmarking privatisation proceeds for investments into future development is also more likely to win over the general public than the established argument that "the government is not a good entrepreneur". An open communication would have to provide a balanced presentation of the advantages and disadvantages as well as the successes and failures and concentrate on promising segments: the proponents of privatisation will no longer have to be convinced and at the same time it is difficult to convince determined opponents, while sceptics and undecided persons may be won over for the issue. The communication strategy must target this group and convey the positive macroeconomic trade-off of investments into future development.

In principle privatisations can be carried out either via the stock exchange ("public offering") or via a private tendering procedure ("private placement"). If the privatisation process is designed according to the strict integrity standards discussed above, the two procedures should not differ substantially in terms of transparency. In this respect both procedures may yield an efficient result, i.e., a fair value of the company at undistorted market prices, if they are designed accordingly. However, a listed company faces substantially more extensive disclosure requirements after privatisation, so that an interested general public can observe the business performance more easily and efficiently than in the case of a private placement. By contrast, assuming an open and fair tendering procedure a private placement may often yield a higher price (due to the block premium) for the government's business stakes.

Particularly for large state-owned companies privatisation via the stock exchange will be the first choice. In Austria there is still a substantial potential for privatisation via public offerings (Alt *et al.*, 2010): firstly, the government's stakes in partly privatised listed companies can be reduced further (secondary public offerings). Secondly, non-listed companies suitable for privatisation could be privatised in an initial public offering. Thirdly, the government owns companies which might potentially be listed but require reorganisation to be sold in the capital market.

Recent studies (Alt *et al.*, 2010) also emphasise the positive effects of a privatisation via the (domestic) stock exchange with respect to keeping corporation headquarters on the national territory and company shares in the domestic financial markets. Privatised companies account for an essential share in the market capitalisation of the Vienna Stock Exchange. Four formerly state-owned companies, the oil and gas company OMV AG, the steel producer Voestalpine AG, Telekom Austria AG and the Austrian Post account for a large share in the Austrian share price index ATX. Their privatisation strongly stimulated the activity of the Vienna Stock Exchange. Similarly positive effects could be expected from future privatisations.

In the literature there is no hint of an optimal moment for privatisation. Certainly, the economic cycle and, consequently, the stock market situation are important. Determining the exact privatisation time requires fine-tuning by the privatisation agency in charge. As a matter of course privatisations will be implemented in a positive macroeconomic and financial environment rather than in a cyclical downturn or a bear market.

In any case the long-term and careful preparation of a privatisation project is more important than the concrete time of privatisation. In the optimal case the responsible privatisation agency schedules every privatisation project in detail for all phases along the lines of a strategic privatisation plan. Thus, it is possible to implement it at short notice without any pressure, when the conditions are considered favourable. These privatisation schedules would have to be reviewed annually and revised if necessary.

Public offering versus private placement

The time dimension

Liberalisation, competition and regulation constitute the most important economic prerequisites for successful privatisations, whereas the approval of the population (and its political representatives) is the main political precondition.

In competitive markets privatisation no longer depends on the economic framework, but the social and political preconditions. However, in the absence of a competitive market environment a government willing to privatise faces the challenge of creating the necessary framework for functioning competition *ex ante* and also of guaranteeing its persistence *ex post*. If a market is characterised by barriers to competition, the government will have to open the market to competition via liberalisation before the privatisation as well as support the market opening by a corresponding regulation and competition policy to ensure that permanently functioning competition can be established. Only under these conditions privatisations can lead to a more efficient allocation of resources than would be the case in a state monopoly or oligopoly.

Besides a "de-ideologisation" and the creation of transparency, it is also necessary to illustrate potential trade-offs in order to achieve social and political approval.

In the past fact-based motives rather than ideology were relevant for nationalisation (Konkurse, Kapitalmangel und natürliche Monopole¹⁶; Tichy, 1998). Today the main economic reasons for nationalisation, i.e., lack of capital and natural monopolies, no longer apply in their original form. In terms of capital availability the situation has changed completely and even reversed: whereas, unlike in the after-war period, there is not only an abundance of private capital, it is rather public capital which is in short supply. With respect to natural monopolies new economic policy options have emerged with the evolution of regulatory instruments. Competitive markets can thus be established via regulation.

In cases, where ideological motives were hardly relevant for nationalisation in the past, ideological positions should not prevent a de-nationalisation today. However, if practical (economic or technical) problems hinder the privatisation of public assets, there is no justification for privatisation "for the sake of privatisation" or "at any cost". These two elementary insights can contribute to a more fact-based and less ideological discussion and serve as the foundation for a more relaxed approach to the issue of privatisation.

Uncompromising transparency is a *sine qua non* for privatisation projects to be credible and accepted by the public. For this purpose, the whole privatisation project has to be designed in compliance with the highest possible standard of transparency.

The OECD (2009) recommends adhering to the "Guidelines on Best Practice for the Audit of Privatisations" of the International Organisation of Supreme Audit Institutions (INTOSAI), to be able to ensure independent external control during the whole privatisation process. In Austria this function could be transferred to the Austrian Court of Audit.

The "integrity pact" of Transparency International, which is adapted to the peculiarities of privatisation projects, could also serve as frame of reference. The integrity pact defines itself as an instrument of prevention and rests on the voluntary self-commitment of all participants in the procedure to comply with certain rules of behaviour. Due to the pronounced public interest (and to negative experience in the past) it is advisable to demand the obligatory self-commitment of each agent involved in the privatisation process or an automatic debarment. Adhering to these strict standards of transparency could gradually restore the confidence of the general public in the proper implementation of privatisation projects.

Government assets are not free of opportunity cost. The capital which is tied in business stakes is not available for other government tasks. If the public interest can also

¹⁶ Bankruptcies, lack of capital and natural monopolies.

be safeguarded with a smaller capital investment, a larger government stake should not be maintained from an economic point of view.

In addition to the (self-evident) option of using the privatisation proceeds to reduce government debt (Aiginger *et al.*, 2010), it would be possible to earmark the privatisation proceeds for investments to enhance long-term sustainable development (research, technology, innovation and education). Government investments in these fields are likely to produce large positive macroeconomic effects in the long run. The effects of such strategic investments on growth and employment can be assumed to exceed the returns on company stakes that are not necessary to serve the public interest. The motto "privatisation proceeds for investment into long-term future development" is also more likely to win over the general public.

Competition forces companies to innovate. Innovation spurs growth and growth ensures employment and prosperity. Therefore, competitive markets are an important precondition for macroeconomically successful privatisations.

Viable competition requires companies that can freely pursue their economic interests. Complete economic freedom can only be enjoyed in privately owned companies. There is no market competition without private enterprise. The privatisation of public assets can spur competition and drive innovation and growth.

According to economic theory government interference (e.g., in the form of state-ownership of companies) is only justified in a market economy, if there is market failure in a broader sense and the particular government interference is suitable to eliminate this market failure.

It is a priority task of the government to ensure sustained viable competition via the respective regulatory and competition policies. Regulators and competition authorities are to be given the required competencies and resources. In this respect there is an urgent "need for readjustment" in Austria.

In competitive markets the privatisation of state-owned enterprises can improve the allocation of resources significantly as the potential for increased efficiency is realised.

If a sustained change of the market structure fails to establish competition, the privatisation of government assets has to be viewed with scepticism as there is a risk that government monopolies might be replaced private oligopolies.

If a market is characterised by restricted competition, the government has to open the market to competition via liberalisation measures and support the market opening by corresponding regulation and competition policies to ensure that viable competition can emerge and persist. Only if these preconditions are fulfilled, privatisation can lead to a more efficient allocation of resources than under a state monopoly or oligopoly.

Not all spheres, where competitive markets did not emerge in the past (in Austria) are necessarily immune to regulatory measures to establish competition. In some industries, such as the Austrian energy sector, there is no serious interest in functioning market competition: economically it is hardly useful to privatise "regional monopolists" as this would only redistribute monopoly profits from the public to the private sector.

There is a strong public interest in a secure and affordable supply of products and services of general interest (energy and water, public transport, mail services) to the population. It can justify a permanent strategic engagement in these companies as a core investor with a blocking minority (25 percent plus one share). A larger stake is not necessary to protect the public interest neither from a company law perspective nor from an economic perspective. It might even be counterproductive, because government investment would crowd out private investment.

From an economic point of view, all other state-owned enterprises that operate in competitive markets and in which the public does not have this particular interest could be fully privatised. For reasons of economic rationality the government should resist the political "temptation" of direct business intervention: in contrast to failures,

Economic policy conclusions drawn from this series of articles

such "success stories" of industrial policy are extremely rare. In general, the collateral damage for other industries or companies and the negative effects on the macroeconomy are grossly underestimated. Instead of choosing alleged "winners", rather, "losers" are protected (Böheim, 2011C, *The Economist*, 2010).

Eventually the concrete scope of privatisation depends on the objectives policy makers define ex ante. This leaves a range of options from complete state ownership to exclusive private ownership. Alternative instruments (e.g., the design of the statutes) can be used as complements to protect the public interest.

At the political level the most important prerequisite for a successful privatisation consists in acceptance by the population (and its political representatives). In addition to a de-ideologisation and the creation of transparency, achieving social and political acceptance also requires a presentation of potential trade-offs.

State ownership has not always been perceived from an ideological perspective. The arguments of the past, such as lack of capital and natural monopolies, are no longer valid in their original form. However, if, in the past, nationalisation was hardly driven by ideological motivations, ideological convictions should not be an obstacle to privatisation today. Certainly, there is no reason for privatisation as an end in itself or "at any cost", if practical (economic or technical) problems provide an argument against the transfer from public into private ownership.

Uncompromising transparency is a sine qua non for privatisation projects to be credible and accepted by the public. For this purpose, it is necessary to draft and organise the whole privatisation project demanding compliance with the highest possible standard of transparency. The "Guidelines on Best Practice for the Audit of Privatisations" of the International Organisation of Supreme Audit Institutions (INTOSAI) as well as Transparency International's "integrity pact" which has been adapted to the particularities of privatisation projects would provide an appropriate frame of reference.

Government ownership of companies is not free of opportunity cost: the capital tied up in business stakes is not available for fulfilling other government tasks. In the long term substantially larger effects on growth and employment could be induced, if privatisation proceeds were earmarked for investments into future development (research, technology, innovation and education) instead of keeping business stakes that are not necessary to protect the public interest. The motto "privatisation proceeds for investments into long-term future development" the general public could be won over more easily.

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The Privatisation of Public Assets as an Economic Policy Instrument: Public versus Private Ownership of Enterprises – The Practical Implementation of Privatisation Projects and Economic Policy Conclusions. Summary

Liberalisation, competition and regulation constitute the most important economic prerequisites for successful privatisations, whereas the approval of the population (and its political representatives) is the main political precondition.

In competitive markets privatisation no longer depends on the economic framework, but the social and political preconditions. However, in the absence of a competitive market environment a government willing to privatise faces the challenge of creating the necessary framework for functioning competition *ex ante* and also of guaranteeing its persistence *ex post*.

If a market is characterised by restraints of competition, the government will have to open the market to competition via liberalisation before the privatisation as well as support the market opening by a corresponding regulation and competition policy to ensure that permanently functioning competition can be established. Only under these conditions privatisations can lead to a more efficient allocation of resources than would be the case in a state monopoly or oligopoly.

Besides a "de-ideologisation" and the creation of transparency, it is also necessary to address potential trade-offs in order to achieve social and political approval.

Uncompromising transparency is a *sine qua non* for privatisation projects to be credible and accepted by the public. For this purpose, it is necessary to design the whole privatisation project demanding compliance with the highest possible standard of transparency and to plan and implement all phases of the privatisation process accordingly.

The OECD (2009) recommends adhering to the "Guidelines on Best Practice for the Audit of Privatisations" of the International Organisation of Supreme Audit Institutions (INTOSAI), to be able to guarantee independent external control during the whole privatisation process. In Austria this function could be transferred to the Austrian Court of Audit.

The "integrity pact" of Transparency International, which is adapted to the peculiarities of privatisation projects, could also serve as a reference framework. The integrity pact defines itself as an instrument of prevention and rests on the voluntary self-commitment of all participants in the procedure to comply with certain rules of behaviour. Due to the pronounced public interest (and to negative experience in the past) it is advisable to demand the obligatory self-commitment of each agent involved in the privatisation process or automatic debarment.

Government assets are not free of opportunity cost. The capital which is tied in business investments is not available for other government tasks. If the public interest can also be safeguarded with a smaller capital investment, a larger government stake should not be maintained from an economic point of view.

In addition to the (self-evident) option of using the privatisation proceeds to reduce government debt (Aiginger *et al.*, 2010), it would be possible to earmark the privatisation proceeds for investments to enhance long-term sustainable development (research, technology, innovation and education). Government investments in these fields are likely to produce large positive macroeconomic effects in the long run. Such strategic investments can be assumed to have a larger effect on growth and employment than the continued investment of public capital into company stakes that are not necessary to serve the public interest. With this "privatisation narrative" – privatisation proceeds for long-term public investments – it would be easier to win over the public.

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