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## **Valuation of Privatization in Europe by Experts and Stakeholders: Results of Explorative Surveys and Interviews**

### **Preliminary Draft Report**

**For STREP Project:  
Understanding Privatization Policy: Political Economy  
and Welfare Effects (UPP)<sup>#</sup>**

by  
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### **Appendices (3 Questionnaires)**

# **Valuation of Privatization in Europe by Experts and Stakeholders: Results of Explorative Surveys and Interviews**

## ***1. Introduction***

For more than two decades, privatization particularly in the areas of fixed telephones, gas, water and electricity supply have been on top of political agendas of governments throughout Europe. These efforts have primarily been guided by the assumption that privately owned enterprises outperform public enterprises in terms of efficiency. However, the implications and actual results of privatization efforts vary to a great extent depending on the sector of the former incumbents as well as on the government's specific approaches towards privatizations and remain heavily under discussion. Based on the Ifo Institute's longstanding expertise regarding business surveys, the Institute was entrusted with the task to explore the perceptions, ongoing controversies and valuations regarding privatization by experts and stakeholders in a selection of European countries. The implementing Institute opted for a three fold data gathering approach.

## ***2. Data gathering approach***

Two series of targeted surveys, and in addition in depth expert/stakeholder interviews in selected European countries were designed and carried out.

In a first survey was a sub-sample of 1000 German firms out of the Ifo Business Climate Survey Panel selected and approached by a mailed questionnaire. The focus was on issues related to Germany.

To get basic information on other European countries a second survey was conducted European wide. The sample was taken from another Ifo panel survey, the World Economic Survey. In this survey participate country specialists (managers and professional analysts).

About three hundred from most countries in Europe were approached by a mailed questionnaire.

The two surveys had a twofold purpose, first to get preliminary information on the present state and important issues, tendencies and controversies regarding privatization in most European countries and secondly to identify Partners for later in-depth interviews.

Since targeted surveys permit little space for the respondent to come up with complex and detailed answers and do not allow the investigator to specify or alter the questions according to the given answers (e.g. ask for reasons and background information or follow-up new information) in-depth interviews with a number of stakeholders and well informed other persons therefore, were considered important. Furthermore, since privatization issues may touch politically and socially sensitive aspects personal face-to-face contacts opened the prospects to explore such issues more adequately.

The report presents the findings of these data gathering activities. It is structured as follows: First, the key findings of the European wide survey will be presented. Second, as a more focussed approach the German managers survey results are described and third as the major part of data gathering the results of the in-depth interviews are presented and discussed.

### ***3. Results of the European wide survey on Privatization***

Due to the structure of the poll the results provide a first idea of how the privatization efforts have been perceived by business leaders and economists in selected European countries. The survey was sent out to 300 country specialists (managers and professional analysts) throughout Europe. Finally, 113 experts from 22 European countries participated (a response rate of 38 percent; many of the experts who did not participate in the survey indicated that they were not well informed on privatization). Since Germany provided the highest number of respondents, the results reflect a corresponding German weight.

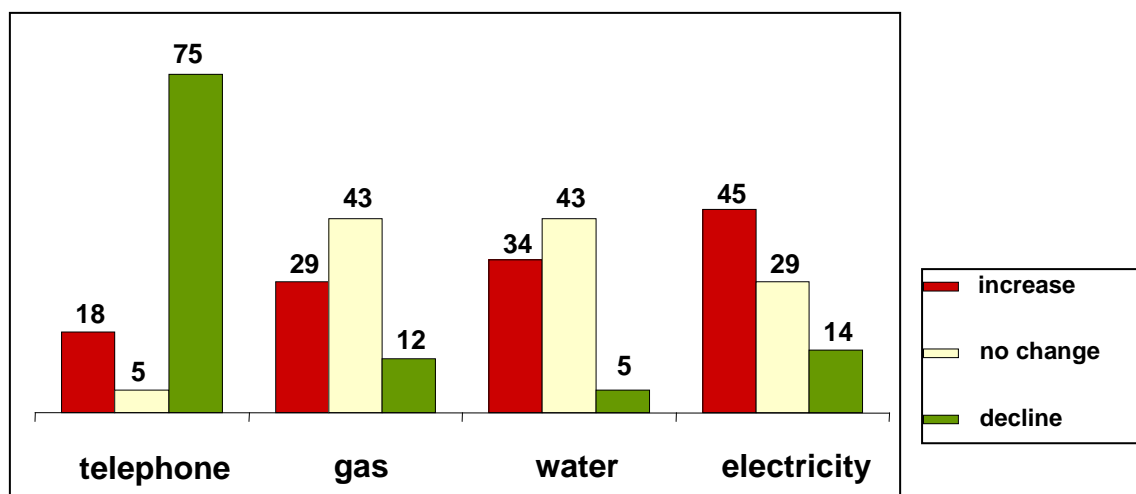
The survey tackles some ex ante considered important privatization topics such as judgements about privatization effects on:

- Consumer prices
- Wages
- Value of shares
- Employment
- Quality consumer choice

### 3.1. Impact of privatization on consumer prices

The survey revealed that according to the surveyed experts prices throughout Europe have, except for telecommunication services, not declined significantly due to privatization. As shown in the graph below a majority of the experts believed that energy prices have even risen after the privatization of the former incumbents (above the level of the international market price for energy). When asked about the development of prices in the water and gas sector most of the experts either stated that prices have not changed significantly or claimed that prices like in the energy sector have risen too after privatization. These findings reveal that falling prices for consumers, a popular claim of privatization supporters, has not yet been fulfilled in most of the utilities. The experts of most European countries stated that due to intensified competition and technological change in the telephone sector, the consumer prices decreased drastically.

Graph1: Effects of privatization on consumer prices in selected EU member countries (in percent)

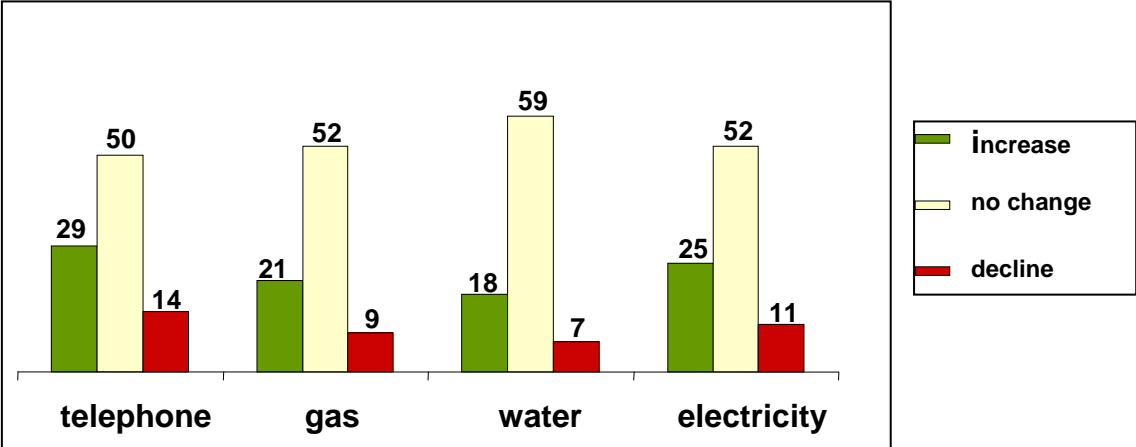


Source: Ifo Institute, European Expert Survey, Spring 2007

### 3.2. Impact of privatization on wages

When asked about the development of wages after the privatization process around half of the experts stated that privatization has not brought about a significant change. However, overall more experts claimed that wages have risen after privatization than fallen. This does not hold for Germany in which case more experts claimed that privatization has resulted in a fall of wages in every sector of the utilities. In fact the survey revealed, that compared to other EU member countries, the average wages in Germany decreased, according to the judgements of the experts, in all 4 sectors, particularly in the telephone sector.

Graph 2: Effects on wages in selected EU member countries (in percent)

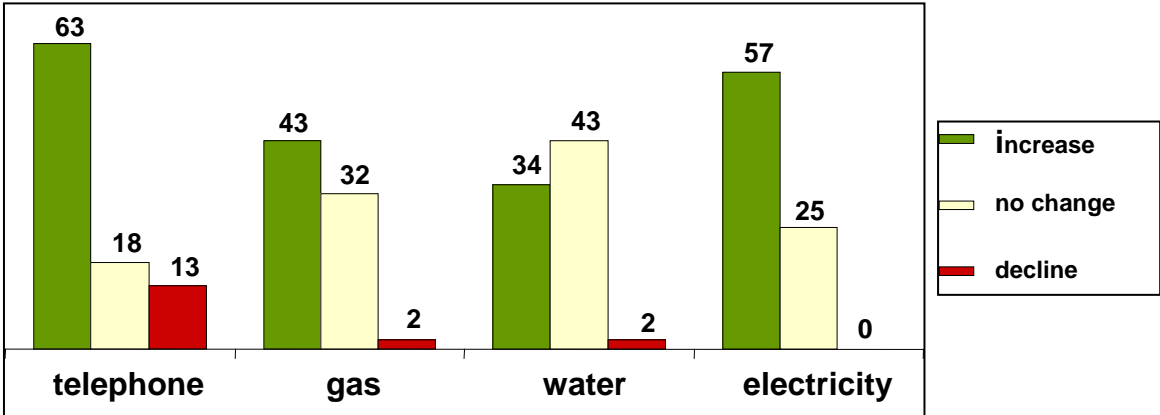


Source: Ifo Institute, European Expert Survey, Spring 2007

### 3.3. Impact on the value of shares

The majority of the experts confirmed that the shares of the former incumbents have gained value due to privatization. They affirmed, as can be seen below, that this is especially true for the telecommunication and energy sectors. Unlike other EU member countries, the value of shares of German enterprises in the telephone sector did not rise; in the other sectors, particularly the electricity sector share prices rose both in Germany and in other EU countries.

Graph 3: Effect on value of shares in selected EU member countries (in percent)

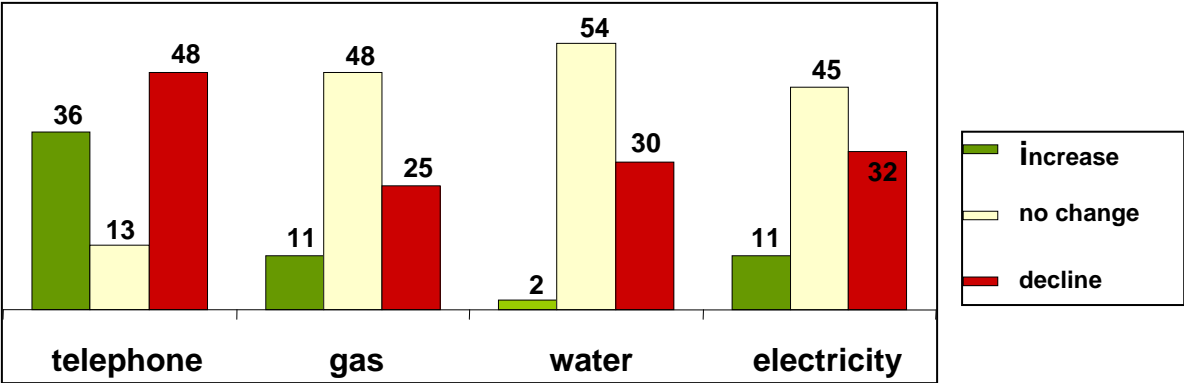


Source: Ifo Institute, European Expert Survey, Spring 2007

**4. Impact on employment**

When questioned about the effects of utility privatization on employment, the experts drew a relative negative picture. On balance in all EU member countries privatization led to a decline of employment. The experts rated the negative effects on employment to be most controvert in the telephone sector where 48 percent of the experts claimed that privatization led to a decline of employment while 36 percent claimed that employment has risen. In all other sectors the opinion is dominated by the reception that privatization either had no consequences on employment or led to a decline (the later in-depth survey showed that experts distinguish between long term macro effects and short term micro effects. In the short run the negative judgements prevail, in the long run more often positive effects).

Graph 4: Effect on employment in selected EU countries (in percent)

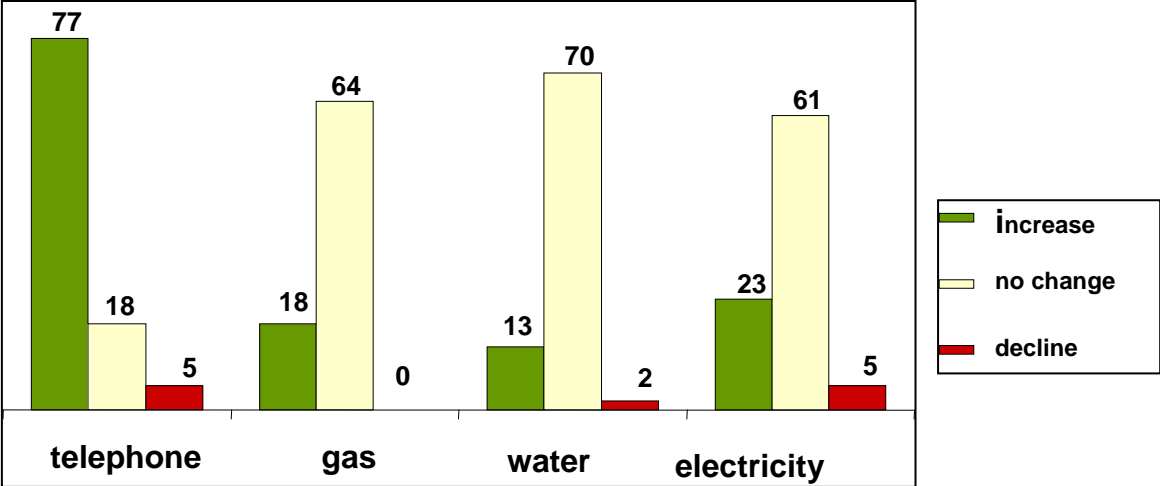


Source: Ifo Institute, European Expert Survey, Spring 2007

### 3.5. Impact on quality of consumer choice

Overall the experts drew a positive picture regarding the effects of privatization on the quality of services and consumer choices. On account of growing competition, the quality and consumer choice increased particularly in the telephone and electricity sector. However, except for the telecommunication sector more than 50 percent of the experts stated that quality has not improved in the gas, water and electricity sector.

Graph 5: Effect on quality of consumer choice in selected EU countries (in percent)



Source: Ifo Institute, European Expert Survey, Spring 2007

### 4. Results of the German Manager Survey on Privatisation

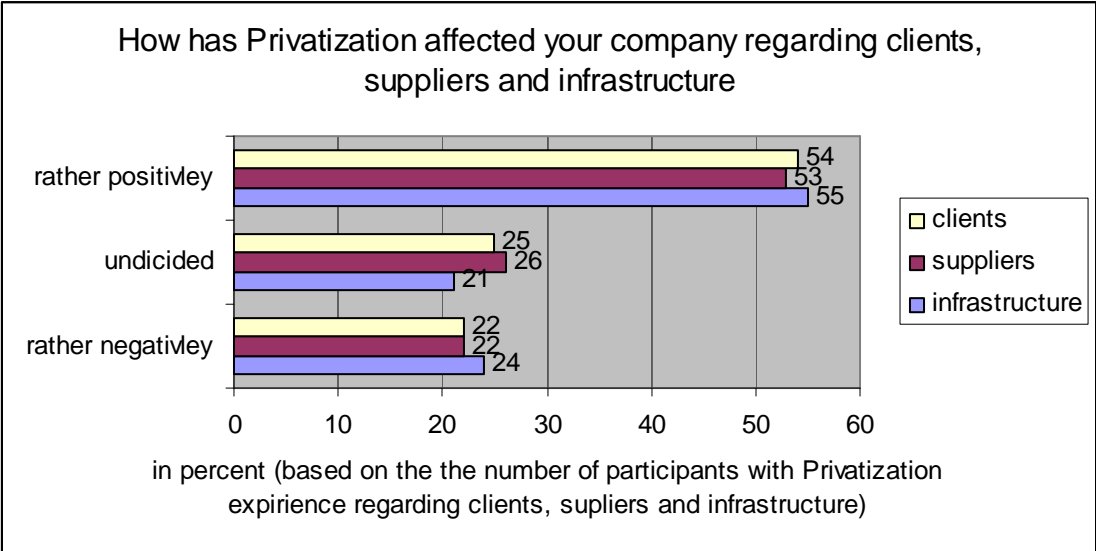
The Ifo Manager survey was conducted in January 2007. The survey was sent to 1000 German managers of German firms. In total 432 managers responded (response rate 43.2 percent). Non respondents often explained that they are not competent in privatization issues. In total 48 percent of the participants belonged to the service sector, the rest was shared between Manufacturing (second), the Building Industry (third) and Trade (fourth position).

More than fifty percent of the participants work for small enterprises with less than 50 employees while four percent of the respondents represent larger Corporations with more than one thousand employees. To avoid redundancies the results of this survey are presented for issues only which go beyond the first European Experts survey.

When questioned whether their companies have been directly affected by privatizations 13 percent stated that they have had experience with privatisation through suppliers, 22 percent through the use of network services and 17 percent stated through their customers, in Germany. The rate fell significantly when asked about cross boarder experiences with privatisations. Moreover, the respondents who had experience with privatization in their company in majority expressed a rather positive view concerning the overall effects of privatization.

The following graphs present the results on questions shown in the title of the graphs.

Graph 6: Does your company have any experience with privatization in Germany? If yes, how do you evaluate it in general?



Source: Ifo Manager Survey on Privatization in Germany, January 2007

Most respondents had not experienced effects resulting from privatization in other countries.. Referring to the small group with experience in this matter, the attitude towards privatisation is also rather positive. Furthermore, the participants where asked if their company faces restrictions on cross-border mergers involving state-owned enterprises. Only very few state that this has been the case. The following countries are named where restrictions had been experienced:

Table 1: Does your company face restrictions on cross-border mergers involving state-owned enterprises?

Country with restriction	Sector of restriction
France (1x)	Other (non-utility/strat.industry) (1x)
Italy (1x)	Other (1x)
Austria (1x)	Other (1x)
Sweden (1x)	Energy (1x)
Bulgaria (1x)	Strategic industry (1x)
USA (1x)	Telecommunication (1x)
China (1x)	Strategic industry (1x)

Source: Ifo Manager Survey on Privatization in Germany, January 2007

## ***5. Results of In-depth Interviews on Privatization Issues in European Countries***

### **5.1. Introduction**

#### *Rationale for in-depth interviews:*

The face to face- expert interviews have two advantages that have been particularly valuable for this research project. First, it enables to receive highly sensitive and first hand information which by other means can not be obtained.

Second, unlike in a secondary data analysis, which relies on ex post data, expert interviews generate information on present and ongoing events and above this may include the attitudes and feelings of stakeholders which have an impact on future economic and political behaviour

#### *Methodology applied for country selection:*

In a first step the target countries were identified. This was done in consultation with the Consortium team. The intension was to include the more important economies of the EU but also taking the country-specific diversity of privatization experience into account. 50 interviews were carried out in 9 countries with altogether 57 individual persons.

Consensus was reached that the following countries reflect both importance and diversity best:

- Austria (3 interviews)
- France (4 interviews)
- Germany (11 interviews)
- Greece (3 interviews with 4 individual partners)
- Hungary (4 interviews)
- Italy (6 interviews with 9 individual partners)
- Poland (5 interviews with 8 individual partners)
- Spain (6 interviews)
- United Kingdom (8 interviews)

*Methodology applied for the expert interviews:*

In a first stage, as explained and shown above, two standardised questionnaires were sent to two different expert samples. The purpose was, as mentioned already, to obtain a brief overview on country specific privatization issues as well as to identify persons who are prepared to participate in expert interviews. The preliminary results of these two surveys were presented in the Project's Praha Conference. During the conference a draft list of possible interview participants, identified by the two surveys, was distributed. This list was amended by consortium members who as country specialists proposed additional potential candidates as interview partners.

In the next step a frame for the structure of interviews (semi-formal questionnaire) was drafted, discussed within the Consortium (by e-mail), amended and finalised. The interviews were designed for a one to two hours questioning and discussion.

The composition of interviewees per country was based as much as possible on the aim to reflect diversity of interests and expertise. It was, however, made sure that at least one interviewee was a knowledgeable specialist from the science community not belonging to an interest group. The rest of the stakeholders were selected from public and private sectors as well as from interest groups such as labour and consumer organizations.

The aim, it must be underlined, was not to receive a somewhat representative view on the positions of interest groups and stakeholders, because this would require methodologies going far beyond the capacities of this Project. The aim was to explore country specific issues, problems and prospects which have important relevance for the one or the other stakeholder as well as for the country specific privatization process in toto.

The potential interviewees were approached in a first step by an letter requesting for participation and explaining the background of the interview action. These letters were followed-up by telephone calls whereby further explanation was given and final decisions on participation and appointments were made.

The interviews in most cases were conducted by two interviewers simultaneously to obtain optimal results. In a number of cases interviewees asked additional specialists to join the interview (especially if they belonged to institutions where several privatization/liberalization specialists were available). Some interviews, therefore, were conducted as group interviews.

The number of interviewees in each country varied considerably according to availability. A minimum of three interviews, however, could be secured for all countries.

The interviews were conceptualized, conducted and compiled by the Ifo UPP research members Prof. Dr. Siegfried Schoenherr, Dr. Gernot Nerb, Dr. Jutta Albrecht, Sen. Researcher Hans Russ and supported by three PhD students, Lars Hornuf, Julius Pahlke and Bennet Schroeder.

#### *Structure of the interviews:*

As mentioned, the interviews were based on a semi-formal questionnaire. Most questions focussed on judgements/attitudes, many of them formalized in scales from 1 to 5 (e.g. “strongly disagree, disagree, undecided, agree, strongly agree”). Most questions in addition to the answer scales gave scope for informal explanations and discussions. The whole interview was concentrated on judgement regarding privatization and liberalization achievements and deficiencies in the utilities sector (fixed telephones, gas supply, water supply and electricity supply). Judgement on the driving and retarding forces of privatization as well as beneficiary and loser groups was sought. Regulatory issues, political and other interventions as well as formal and informal political dynamics were to be discussed and a final statement on success or failure of the privatization programme to be made by the interviewee. (Questionnaires see Appendix)

The questionnaire frame was pre-tested, amended and all interviewers instructed on its concept and how to proceed. During the interviews the questionnaire in general proved to be adequate under the varying country and stakeholder conditions.

The most important results are presented by country in the chapters following.

## **5.2. Valuation of Privatization Issues in France**

In the case of France interviewees represent the following stakeholders: The public sector, academia, international organizations and the central bank. In total four face-to-face interviews were carried out.

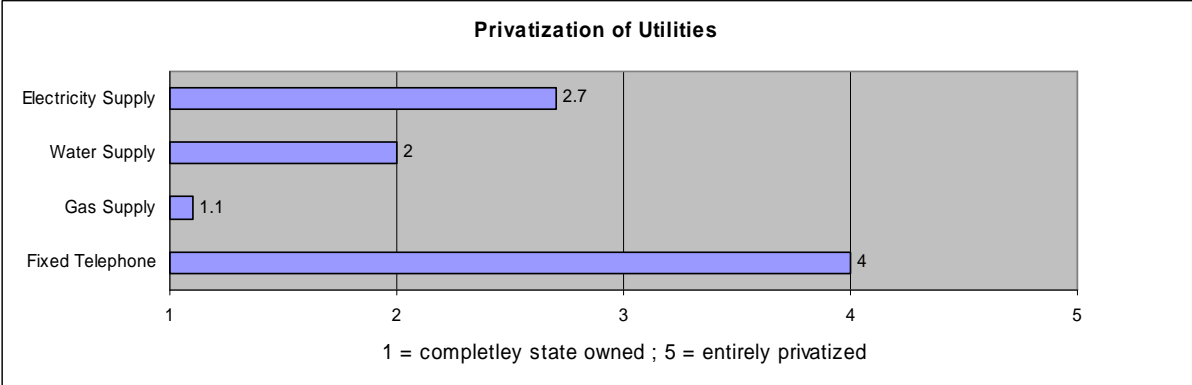
### **5.2.1. The Current State of Privatization**

The belief in the French central state as well as the Bonapartist and Gaullist heritage hamper a broad and scientific debate on privatization issues in the French society these days, which is detached from ideological paradigms. During the violent riots in various French cities, reaching a peak in the year 2005, which were after all showing the urgent necessity of reforms, numerous French people expressed their anger over the inability of the French government to fight unemployment – an artefact, that is not least due to the French pursuit to keep the centre of control in national hands. Considering the long tradition of industrial policy in France, all of the interviewees shared the opinion, that an industrial policy with publicly owned companies is necessary. The existence of monopolies was justified for efficiency reasons - arguing that some of the industries are natural monopolies - and the need to provide firms with a sufficient financial endowment. Some respondents expressed their concerns, that the provision of universal services may be endangered through the operation of private companies.

Initial privatization efforts started in France with the first legislative period of Jacques Chirac in the mid 1990s. The European Union was commonly seen as a fundamental driver of privatization by the experts. They stressed the importance of two very influential channels fostering a policy change. Firstly, when the single market initiative was launched in 1985, it was steadily forcing European governments to further liberalize their markets. Since many of the French state owned enterprises suffered from typical monopolistic problems, namely inefficiency, overpricing and excessive bureaucratic procedures, selling these firms was sometimes the only way to deal with the upcoming market liberalization. Secondly, the creation of the single currency, for which the Maastricht debt and budget deficit criteria were established as an entrance precondition, obliged the French state to consolidate its finances. The budgetary requirement gave the government an additional incentive to privatize firms.

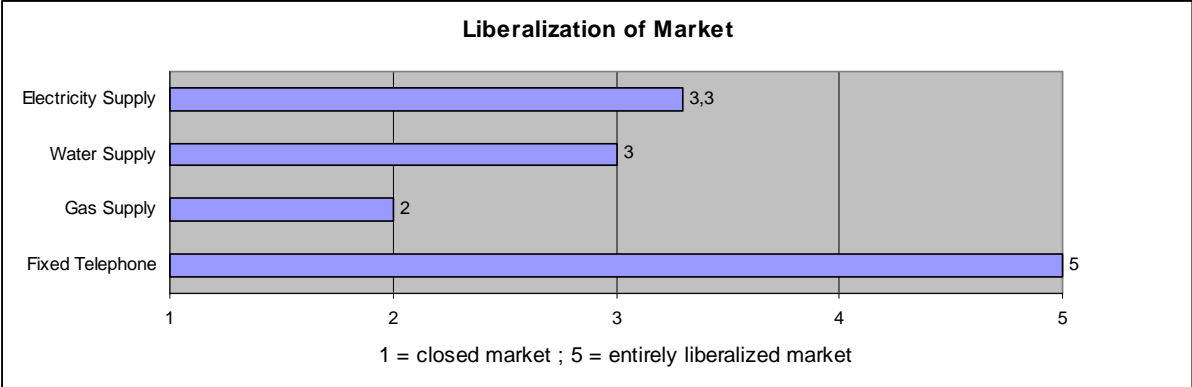
Even more important than the revenues raised by selling firms, was the motivation to get rid of state owned corporations in order to achieve that loss-generating companies did no longer put a strain on the financial records of the state. A minority of the interviewees argued, that a major rational behind selling state firms was, to use the fresh revenues to subsidize other state owned corporations.

Graph 7: Current state of privatization according to French experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 8: Current state of liberalization according to French experts/stakeholders



Source: Ifo interviews on privatization 2007/8

**5.2.2. Present Driving and Retarding Forces**

There has been a general agreement among the interviewed experts that pressure from political forces and interest groups was slowing down liberalization efforts in the last years. The respondents identified the relevant stakeholders retarding liberalization as the unions and the public sector as well as the altermondialist movement. The arguments these interest

groups put forward draw primarily upon the security of supply and the public good character of the respective sectors. On the other hand, the privatization of large corporations was mainly driven by the objective to merge them, with the ultimate goal to create National Champions. Furthermore, the privatization of firms was in some cases pushed forward to reform the pension schemes, switching from a diversified to a unified system. The consolidation of government revenues played obviously an important role in selling firms.

### **5.2.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

The current situation concerning the privatization of state owned enterprises is rather undisputed. Apart from the privatization of France Telecom, utility providers (gas and electricity) are still to a large extent under the control of the French government. Regarding France Telecom, many of the experts addressed the issue, that the corporation still holds a quasi-monopoly position, as it exclusively owns and administers the fixed telephone network. In the opinion of the interviewees, the competitiveness of the fixed telephone market does not suffer from this situation, since all of them argued that competition is high in the sector. According to the statements given, fixed telecommunication providers are readily available. The situation in the other branches looks somewhat different. There is no market for gas and electricity services in France as indicated by the experts, because Gaz de France / Suez and Electricité de France hold nearly monopolistic positions. The competitors Gazprom, Total, ENI and BP respectively hold one-digit market shares on the gas market. The stakes of private energy providers like POWEO are likewise small. Due to the natural monopoly character, the water sector can hardly be liberalized according to all experts interviewed. Apart from one respondent, all interviewees argued that the French government still influences privatized companies. The major sources of influence are voting rights and government ownership as well as the strategic appointment of people in the board of directors. The state owned investment bank Caisse des Dépôts et Consignations influences private sector firms according to only one interviewee. In the energy sector government control is mainly exercised through the fixation of prices. None of the respondents argued, that the influence of foreign investors should generally be limited, while one interviewee made a distinction between EU and Non-EU investors. In addition, there were no resentments with regard to a particular investor type.

When interviewees were asked whether privatization improved the corporate governance, all experts agreed unanimously.

Finally, the focus of the interviews turned to the issue, whether the network infrastructure should be separated from the network service. All respondents agreed that the service provision should be disconnected from the infrastructure. The highways as well as electricity and the railway system in France were cited as positive examples. Nearly all experts claimed that it was either too early to say whether regulatory authorities worked effectively in France or that they simply did not know how well they currently perform.

#### **5.2.4. Winners and Losers of Privatization**

The experts were asked whether privatizing firms like France Telecom was beneficial or harmful to individual parts of society. The opinions of the experts as regards the effect of privatization on employees diverge. On the one hand, the employees of France Telecom benefited from privatization, as they have been offered to buy staff shares at benevolent conditions. On the other hand, some of them apparently lost their jobs after privatization. The managers of the newly privatized companies have gained power, as they are now enjoying more freedom in the decision making process. Nevertheless, they are still extensively restricted in management decisions, since the government owns a majority of the company shares. This is especially evident in the case of Electricité de France. The representatives of the labour force, which are the unions, lost already some of their influence in the course of privatization, mainly because they were largely represented in the public sector.

#### **5.2.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Price Levels and Services**

To evaluate which consequences the privatization process had so far, each expert was asked to give a statement on a five item scale or to indicate a general tendency, which she was supposed to explain. Not surprisingly, it was argued that the privatization of France Telecom and the partial privatization of Electricité de France increased competition in the telecommunication and electricity sector and improved the business efficiency of the respective firms. That this notion is indeed accurate was just recently attested by the Ifo

Institute (2007) using hard data on market shares and unit prices. Moreover, while in the fixed telecom sector the unit price of the former incumbent dropped and was assessed as competitive compared to private rivals, the French energy sector did not see such a price decrease. The major reason for this sluggishness is that energy comes primarily from nuclear power plants, which impose low costs on energy provider keeping the consumer price equally low. Beyond this reasoning, prices did not change in the energy sector as they have been fixed by the national government, which made a decline in the energy price de facto impossible. With regard to services, France Telecom has been assessed as a good provider, not least because the former incumbent apparently has a highly skilled staff.

Apart from the structural problems, which are in the electricity sector due to the fixation of prices and which put constraints on each corporation alike, the French experts disagree whether foreign companies face operational difficulties accessing the markets and whether financial market barriers are in some way erected by the government.

All respondents agreed that water and electricity supply are sectors that provide a public good, while there was no clarity if this is the case for fixed telephone and gas. Nevertheless, the possibility of contracts between state and private operators was mentioned, to achieve certain public good functions, like universal access to services. It was stated that the government established the provision of universal services in the case of railways, electricity and postal services by law and mitigated social hardships by means of a fund, allowing low income earners to get cheaper access to electricity and telephone providers.

### **5.2.6. Public Opinion towards Privatization**

According to the experts that have been interviewed, the prime issue in the French society concerning privatization is the welfare of consumers. They indicated that both the evolution and the volatility of prices as well as the provision of services are of major concern. Apart from that there is an obvious fear in society to become unemployed as firms will be privatized.

### **5.2.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

To conclude, privatization is a very sensitive issue in France and it will be very difficult to initiate a scientific debate about the costs and benefits of privatization that is joined by the media and the broader public. Evidently, France has a long history of industrial policy and planification the consequences of which can be traced back to the present day. Although all experts claim that privatization in France was successful until now, they see only very limited scope to extent the process to other sectors. Still all interviewees stated that further moves are necessary, in particular in the railway sector. The transport of goods and materials is apparently highly inefficient and was strongly recommended to be privatized. One way to move forward, as it was argued, is to rely on the support and regulations of the European Union, a trick that worked very well before.

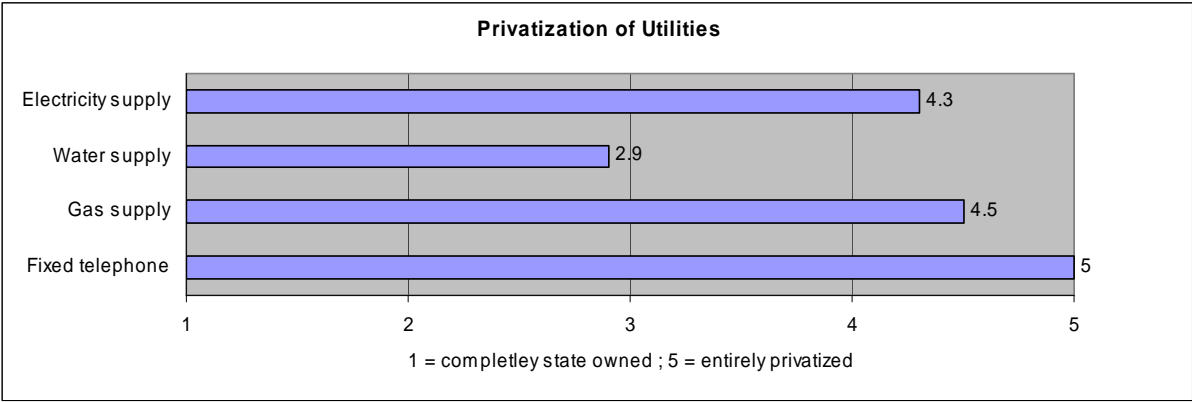
## ***5.3. Valuation of Privatization Issues in Spain***

In total six face-to-face interviews were conducted in Spain. The interviewees represent the following interests: industry, academia, the regulatory authority, a former member of Parliament as well as the public sector and the Government Commission for Privatization.

### **5.3.1. The Current State of Privatization**

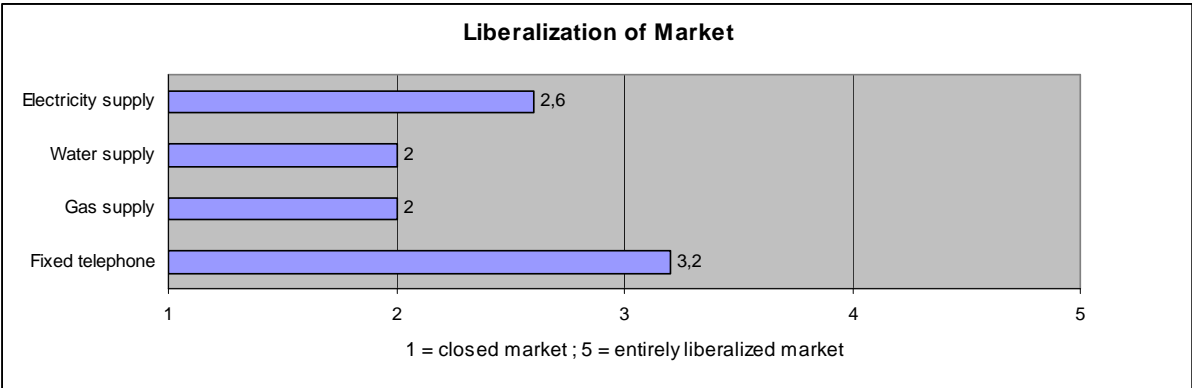
After the first stable parliament was voted for in the year 1982, the Spanish labour party Partido Socialista Obrero Español (PSOE) remained in power for 14 years. During this period the Spanish government followed a privatization strategy rather similar to the French policies, namely the creation of National Champions with the pursuit to conquer foreign markets and to control the domestic one. After the socialist period came to an end, the conservative party enforced a speedier and primarily for the state finances lucrative privatization policy by selling-off shares from the largest utility companies, like Telefonica, Endessa and Repsol to name just a few. This change in policy was largely needed to keep the Spanish public deficit below the three percent ceiling of the Stability and Growth Pact. Today privatization is no longer a hot topic in Spain, as all interviewees consistently stated.

Graph 9: Current state of privatization according to Spanish experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 10: Current state of liberalization according to Spanish experts/stakeholders



Source: Ifo interviews on privatization 2007/8

**5.3.2. Present Driving and Retarding Forces**

Interestingly, almost all interviewees negated that any interest groups slowed the liberalization process down in the last years. It was argued instead, that the regional division was more interesting to look at, when it comes to the question whether privatization will move forward or not. The central government is apparently driven by the idea that only privatized companies can compete in global markets and even more important that privatization is the only way by which these firm can expand through international mergers

and acquisitions. On the regional level, however, the governments are more interested in creating Private Public Partnerships, with the aim to exclude expenses from the budget.

According to the experts, the two major factors that are retarding future privatization projects as well as the abolition of golden shares in Spain, is the concern about the national sovereignty and the anxiety with regard to the security of supply.

### **5.3.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

The following results can be inferred from the expert interviews. The fixed line telecommunication market in Spain still lacks real competition. Telefonica, the former Spanish monopolist, still occupied around four fifths of the market by early 2007. Several mergers and acquisitions created an economic giant, which is nowadays not only controlling the Spanish market. Having worldwide the second most customers and third highest market value in its branch, Telefonica is one of the very important global players in the telephone sector. Although all experts agreed that the corporation is entirely privatized, they have indicated that the Spanish fixed telephone market nowadays suffers from a high degree of concentration.

The gas market in Spain is still separated into a regulated and a liberalised segment. After the partial market opening in 1998, access to the gas network was virtually not feasible for private competitors, since Gas Natural solely owned the transmission system. Just recently, the incumbent has been unbundled from Enagas - the operator of the transmission infrastructure - and access to the gas network became possible for private gas providers. As a consequence the market share of the former incumbent fell considerably, in particular in the industrial segment. In the last five years Endesa, Iberdrola and Union Fenosa among others made their way onto the Spanish gas market. According to the experts, the complete privatization of Gas Natural is undisputed, while there is some controversy about the liberalization of the gas market in total. The water sector in Spain is organized on a regional level just as in many other European economies. Aguas de Barcelona (Agbar) and Fomento de Construcciones y Contratas (FCC) together hold around 80 percent of the private water management business as well as 100 percent of the joint venture market in Spain. The French water giant SUEZ which recently merged with Gaz de France to avoid a takeover by the Italian company Ente

Nazionale per L'energia Elettrica (ENEL), is currently holding a 30 percent share on Agbar. According to the respondents, Spain still exhibits numerous public water providers.

Generally speaking, it can be said that the Iberian (Spanish and Portuguese) electricity market is one of its own. No other European supplier was able to join the Spanish market apart from the Portuguese incumbent EDP and the Italian company ENEL, which both hold shares in Hidrocantabrico and Viesgo. Although the government does not possess large shares in the Spanish electricity provider Endesa and the power grid operator Red Electrica, it still holds golden shares in both companies. According to the interviewees, the Spanish electricity sector is largely under the control of Spanish companies like Endesa, Iberdrola, Union Fenosa, Gas Natural and is not very liberalized. It was argued, that this situation is partly due to the geographical location of Spain, making it difficult to supply energy to the peninsula.

While only two interviewees alleged that the Spanish utilities are protected through financial market entry barriers, the remaining four did not see such problems. Moreover, most of the respondents did not indicate that there are operational difficulties for foreign companies to enter the market. Nevertheless, two of them stressed, that it was difficult for gas and electricity providers to directly access the network, mainly due to the geographic location of Spain. The only way a foreign company could enter these sectors, it was noted, is through a takeover of existing firms. The universal provision of services is guaranteed in the fixed telephone sector. There is also a fund to mitigate social hardships. For other sectors none of the respondents did know of any measures that have been undertaken by the government.

This part of the interview was concluded by asking about the public good character of the sectors. One respondent argued that telephone, gas, water and electricity are all very sensitive products and the government should take care that everybody is able to use them. Another expert argued that most of the sectors lost its public good character as nowadays there are a lot more substitutes available to all of them. In other words, people do no longer rely on a fixed telephone provider as mobile calls are comparably cheap.

As regards the influence of an investor, it was repeatedly argued that any type of public investor - whether foreign or domestic - might not be very suitable to be represented in the management of a privatized company, in particular if the respective government is not very democratic. Furthermore, while there are already Algerian and Russian gas providers

operating in the Spanish market, one of the experts was concerned that these providers get their hands on the infrastructure.

There is unanimity among the respondents, that the government still influences privatized companies. Most obvious was the intervention of the government in the case of Endesa and the takeover attempt of the German energy provider E.ON. Surprisingly, only one of the respondents mentioned golden shares as an important source of influence by the government. There was nevertheless a broad agreement, that the strategic appointment of supervisory or executive elites in privatized enterprises as well as special relationships in the economic and political arena play an important role in influencing privatized companies. Only one interviewee disputed this claim. Furthermore, it was argued that the state is exercising power through the setting of prices and more precisely the approval of tariffs. One respondent noted that in the energy sector state subsidies played a major role, to foster renewable energy technology, with the ultimate goal to create a National Champion in this branch.

When asked whether the service provision of a utility provider should generally be separated from the network provision, all respondents affirmed this claim. The experts admitted that there were problems in Spain defining the access conditions to the networks, but eventually the unbundling succeeded in the gas and electricity sector, while there are still problems in the fixed telephone branch.

When the experts were asked whether regulators should be transitory or long-lasting, there were reasonable arguments in favour and against a limited lifetime of a regulatory authority. Experts that were against a long-standing regulator, argued that if the institution succeeded in liberalizing markets, it would have no more rationale thereafter and competition policy should be handed over to an antitrust commission. If on the other hand, a regulator is not successful in establishing competition, the body would have no legitimization either and the bureaucratic apparatus would simply grow by holding it up. These arguments were countered by the prediction that there will never be perfect competition in any market and that therefore a regulatory authority was needed to be long-standing.

While most of the respondents saw the effectiveness of the regulatory authority as strongest in the fixed telephone sector, the institution apparently lacks power in the gas and electricity branch. This is mainly due to the fact that tariffs are set by the ministry. Moreover, half of the

respondents claimed that the regulator is not truly independent and thus requires sovereign authority.

#### **5.3.4. Winners and Losers of Privatization**

Now we will again turn to the issue how privatization policies were implemented and which parts of society gained or lost from these measures. As regards the employees, it was stressed by some respondents that there was actually no reduction in workplaces, since privatized companies were growing and thereby additional jobs were created. While having to work harder, most employees benefited through salary increases. This was also true for the management. Spanish consumers generally gained from the privatization of state owned companies, which is most obvious in the case of the airline industry, where prices decreased dramatically. Some interviewees explicitly argued that the precise effects of privatization are hard to disentangle, but that the process as such brought a Pareto improvement for society.

#### **5.3.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Price Levels and Services**

Not surprisingly, all interviewees agreed that privatization improved the corporate governance of the respective corporations, although there are still concerns as regards the independence of the board members. Nevertheless, the transparency and the information publicly provided by these firms improved considerably.

There is not much confusion whether prices decreased after privatization. This was most obvious in the case of the fixed telephone sector, as this is the market which shows the largest extent of liberalization. Despite the institutional and competitive progress, the gas prices followed the international trend and did not stop growing. Nonetheless, they have been developing more benevolent in the industrial sector. As regards the electricity market no interviewee claimed that there was an improvement in prices.

All of the experts affirmed that the business efficiency of the utility providers improved, while one respondent made the case that this was primarily due to technological developments. Nevertheless, all interviewees claimed that the former incumbent Telefonica adjusted its

prices rather rapidly after its privatization and became sufficiently competitive to survive in the market. The experts did not have a clear opinion whether such a development took place also in the gas and electricity market. Finally, it was very often stated that in particular the service of Telefonica and Endessa improved considerably.

### **5.3.6. Public Opinion towards Privatization**

The prime issue as regards privatization in Spain is according to the interviewees the consumer welfare, meaning the continuity of service provision. Apart from that, all respondents claimed that there is no debate on privatization in the Spanish society today. The interest groups retarding further privatization are according to one respondent the Greens, whereas another interviewee saw economic think-tanks and the media - especially the newspaper *Expansión* - as the forces driving the privatization process further ahead.

### **5.3.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

Overall, it can be argued that Spain followed more the French style of industrial policy by creating National Champions, but the British archetype of a complete and rapid privatization of firms. With regard to other sectors, precisely healthcare and education, there are already established private and public institutions in Spain. The railway company Renfe is owned by the state, but according to the interviewees ownership is not disputed by society, while the liberalization of the network is. To sum up, the picture in Spain looks as follows: The privatization process of the big utility providers is largely over. Nowadays, the importance lies in the establishment of competitive markets. Although the focus of liberalization was until now primarily on the fixed telephone sector, the former incumbent Telefonica still owns more than half of the market share. In the other sectors, namely gas and electricity, the fixation of tariffs largely hampers any real competition.

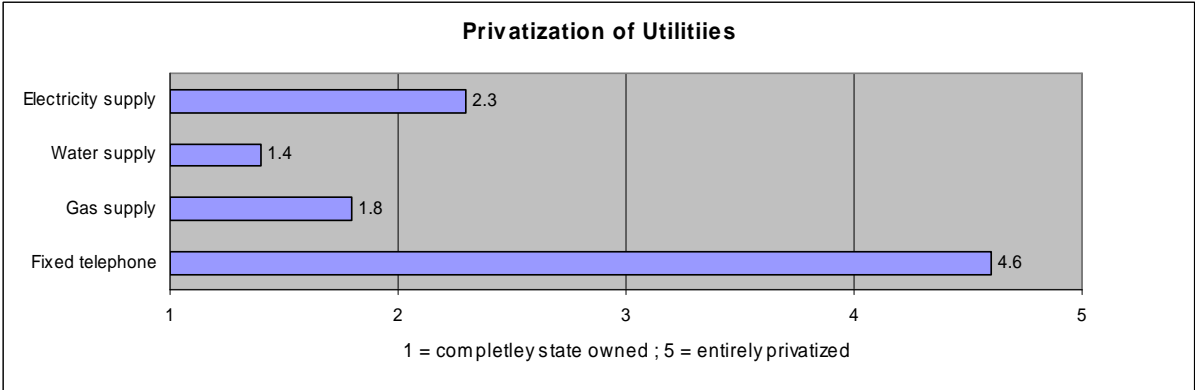
## **5.4. Valuation of Privatization Issues in Poland**

In the case of Poland interviewees represent the following interest groups: The private and public sector, academia, the trade union, the regulatory authority and the central bank. Overall five appointments with different organizations were arranged. In some cases consultations took place in small groups, which helped the interviewers to account for different interests within the respective institutions.

### **5.4.1. The Current State of Privatization**

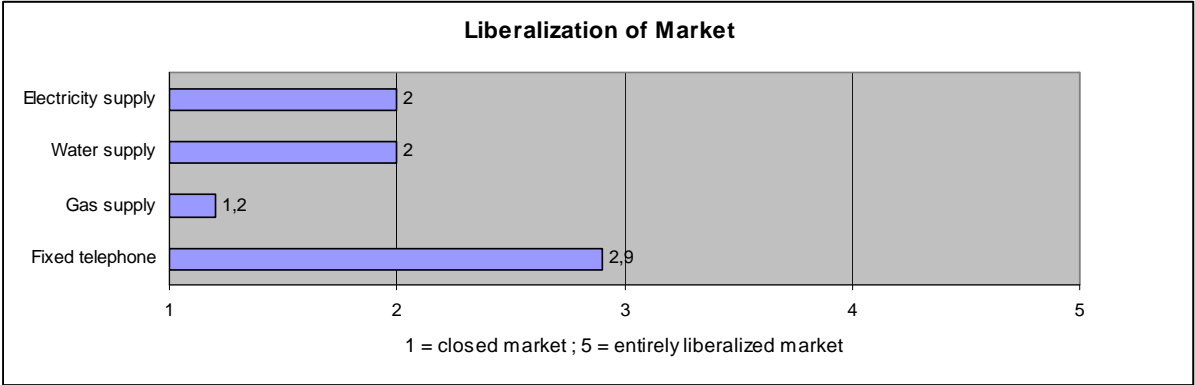
The privatization process in Poland is fundamentally different from the developments in Western Europe, because many economic policies were implemented in the shadow of a previously planned economy. In the early 1990s the quality and the pace of the privatization process have suffered from the political and social peculiarities in Poland. The fragmentation of the party system has resulted in considerable political instability, which is evident from ten different government majorities between the years 1990 and 2001. This state of affairs was obviously not supporting a stable and consistent privatization policy. While the small-scale privatization program began immediately after the communist era came to an end, starting with the privatization of stores, restaurants and small production units that previously belonged to local government bodies, a large-scale privatization process was greatly postponed. Three major initiatives to sell-off larger corporations were started in the first half of the 1990s. There was firstly the mass privatization through the voucher method supported by Solidarity. Secondly, the “Pact for Industry” under which each divestment plan was worked out by a tripartite commission made up of management, unions as well as government representatives and thirdly private investment funds. However, the weakness of the government resulted in a failure to pursue a straight divestment strategy until the year 1997. Since then considerable progress was made. Among the economic reforms preliminary to the accession of the European Union, a large-scale restructuring and privatization plan was drawn up, causing repeated waves of worker protests and strikes, since the industrial sector was the one most affected by job cuts. As a result of this development the percentage of total output produced by the public sector plunged from about 90 percent in the early 1990s to nowadays below 20 percent.

Graph 11: Current state of privatization according to Polish experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 12: Current state of liberalization according to Polish experts/stakeholders



Source: Ifo interviews on privatization 2007/8

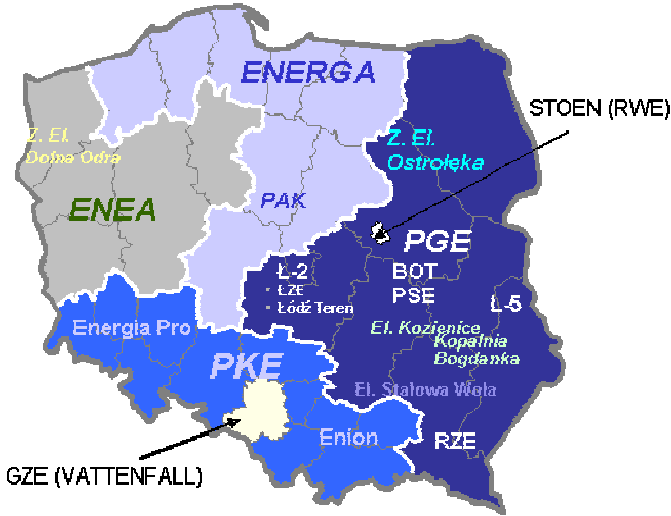
**5.4.2. Present Driving and Retarding Forces**

When asked whether political forces or interest groups were slowing liberalization efforts down in the last years, solely one expert confirmed this claim. Interestingly not the left wing parties but the conservatives are seen as retarding further privatization project. The public sector, consumers as well as the labour force have been commonly identified as the major forces in society driving the privatization process ahead. However, one expert mentioned that a few employees are afraid that a competitor might buy a firm, with the sole purpose to close it down to get rid of a competitor.

### 5.4.3. Liberalization and Competition, Investment Policies and Regulatory Interventions

In the telecommunication branch the privatization of Telekomunikacja Polska S.A. is largely completed. A first tranche (15 percent of the capital) was sold by a public offering in 1998 raising almost US\$900 million. In a second phase (2000-2001), 47.5 percent were sold to a consortium headed by France Telecom and Kulczyk Holding for US\$5.2 billions. A further public offer in 2003 generated proceeds of another US\$436.4 million. Finally, a last tranche of 1.94 percent was offered to domestic and international institutional investors generating revenues of almost US\$110 million. All interviewees confirmed that the former incumbent Telekomunikacja Polska S.A. is nowadays fully privatized, while at the same time respondents unanimously agreed that the Polish telecommunication market is only in theory liberalized.

Graph 13: Energy Groups in Poland



Source: Energy Regulatory Office

In March 2006, the Polish government approved a new energy sector strategy that created four energy groups, with the aim to privatize them later on through Initial Public Offerings (IPOs). The biggest group is Polska Grupa Energetyczna (PGE) which combines elements of Poland's national power grid Polskie Sieci Elektroenergetyczne (PSE), the power plants BOT and Dolna Odra and eight power

distributors in the central part of the country. Apart from the other three Polish energy groups, Vattenfall and RWE are the first foreign energy providers operating in Poland. During the time of the interviews, every single entity was working regionally separated from the others (see graph). For this reason all of the respondents stated that there was neither progress in the privatization of the energy groups, nor did any liberalization of the market take place until recently. Since fall 2007 however energy providers are allowed to operate beyond the artificial created borders, which is a development that will obviously contribute to a more competitive energy market within Poland's borders.

In the year 2005 there were 603 enterprises operating in the Polish water supply sector. Among them were 289 enterprises liable to governmental budgets, eight auxiliary corporations, 294 limited liability firms and twelve stock companies. Privatization was accomplished in the case of 29 limited liability corporations. Stocks of three public companies were partly sold. This impression was commonly shared by all of the interviewees, stating that privatization was on track, but is far from being perfect.

With regard to the gas market, there is unanimity among the experts that the former incumbent is barely privatized and that a liberalization of the market did not take place yet. In the year 2005 a 15 percent stake of the gas exploration and distribution company PGNiG was sold. The IPO generated revenues of more than US\$800 million.

As a result of the interviews four out of five experts confirmed the notion that the Polish government is influencing privatized companies. As in other countries interviewees claimed that social links as well as the strategic placement of people in the board of directors was a key method to exert pressure on formerly state owned firms. The influence through ownership rights had a similar weight in the opinion of the respondents. Only one interviewee mentioned that golden shares still play a role.

To sum up, the recent situation in Poland can partly be explained by the government pursuing nationalist policies, with the aim to create a Polish National Champion under the control of the state. It is therefore not surprising that all of the respondents identified the creation of National Champions as hampering privatization efforts. The majority of the experts argued, that concerns about the security of supply have a negative impact on the denationalization of firms. Finally, there was unanimity that the consolidation of the national budget was a major objective in the privatization process in the past.

As regards the type of shareholder most suitable to manage a privatized company, many interviewees claimed that foreign investors are certainly advantageous. This claim was made since most experts expected foreigners to promote the corporate governance structure and the human capital of the respective firm as well as its prospects to generate additional funds. Know-how transfers from companies like Vattenfall and France Telecom have been mentioned as positive examples. Hence it is not surprising that none of the experts wanted to limit the influence of foreign investors in Poland, while some caution was mentioned in the case of Gazprom. After all, three out of five interviewees claimed that privatized firms have better corporate governance standards.

When asked whether the network infrastructure should be separated from the service provision, all but one respondent confirmed this statement. The gas and electricity sector have been stressed as positive examples for a dismantling. It is important to note, that the majority of the experts hesitated to recommend a privatization of the network, indicating that private firms might not have the right incentives to make the necessary investments.

Finally, all respondents agreed that regulatory authorities should not only be transitory but long-standing institutions. The major argument was an *ordo-liberal* one, namely that there will always be tendencies towards concentration through mergers and acquisitions. As regards the current effectiveness of these institutions, the regulatory authority was seen to work rather successful in the telecommunication sector, while in particular in the gas market it lacks some teeth.

When discussing the public good character of utility providers and ethical questions as regards the privatization process, most of the respondents addressed security and safety issues. In particular the privatization of the network was not regarded as being advisable.

There was a large disagreement among the interviewees whether foreign companies face operational difficulties or financial entry barriers when accessing Polish markets. While in the gas and electricity sector there is a fixed amount of licences that companies can obtain to trade energy or provide gas, there is apparently no competition to buy such a license. Other practical problems have been mentioned, for instance the requirement to store a certain percent of the capacity to name just one. Two of the interviewees stated that many foreign investors do not have a particular interest in entering the market, as too much investment would be needed to operate a business and expected revenues might not fully compensate for this.

#### **5.4.4. Winners and Losers of Privatization**

Not only the interest groups pushing privatization project in Poland ahead are unlike the ones in Western Europe, also the beneficiaries of the process are apparently others. Apart from one respondent who did not make a clear statement, all experts agreed that privatization was beneficial for the employees of privatized firms. They gained according to the statements made primarily from the allocation of free shares and the payment of higher wages. Moreover, in the course of a social pact investors and the union negotiated employment

guarantees. Set-off worker got “golden handshakes” granting them very generous compensations. The losers in society have been according to the interviewed experts the workers who stayed in the public sector. Most of the respondents claimed that the public as a whole benefited largely from the privatization of formerly state owned enterprises. However, one expert indicated that in the case of Bank Pekao S.A. the proceeds of the government from the sell-off are now the annual profits of the firm, which has created some doubts on how privatization was actually implemented.

#### **5.4.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Price Levels and Services**

Apart from the fixed line telecommunication sector and to some degree the electricity market, real competition has been negligible in the four sectors we discussed until now. The two branches just mentioned have also been indicated as the ones where former state owned enterprises have exhibited the largest improvement in their service quality. According to the experts, price changes resulted from international price trends, but are not the outcome of the privatization of state owned firms. It was furthermore indicated by the interviewees that the competitiveness of the former incumbents is nowadays mainly due to the ownership of the network. The business efficiency of the firms improved according to the respondents only in the case of Telekomunikacja Polska S.A.

#### **5.4.6. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

Poland is without doubt a special case as regards privatization – the unions are in support of privatization, while nationalist interests in the government attempt to prevent it. Employees of firms which did not take part in the privatization process are widely seen as the losers in society. Although none of the respondents claimed that privatization was a failure, only half of the interviewees indicated that it was a clear success. Privatization efforts in Poland did not stop in the utilities already discussed. According to the experts there are private universities, schools and hospitals. Attempts were made to privatize even certain parts of the military sector. It was argued by the interviewees that further progress has to be made in the area of coal mining, banks and the stock exchange. While previously only revenues from IPOs

mattered, today the Polish state becomes more and more concerned about the profits a state owned enterprise might generate, especially if it is capable to take on the position of a National Champion. Although it may be surprising for some liberal economists, it has been shown in the literature that this pursuit can indeed increase aggregate output and welfare in the European Union (Sinn, 2003).

## **5.5. Valuation of Privatization Issues in United Kingdom**

In the case of the United Kingdom some more interviews were conducted since it was assumed that a wider range of information due to the long lasting experience and pioneering role could be gained. Among the interviewees were representatives from the competition authority, trade unions, academia, the consumer protection alliance, the public sector as well as the Institute for Economic Affairs. In total eight experts were interviewed.

### **5.5.1. The Current State of Privatization**

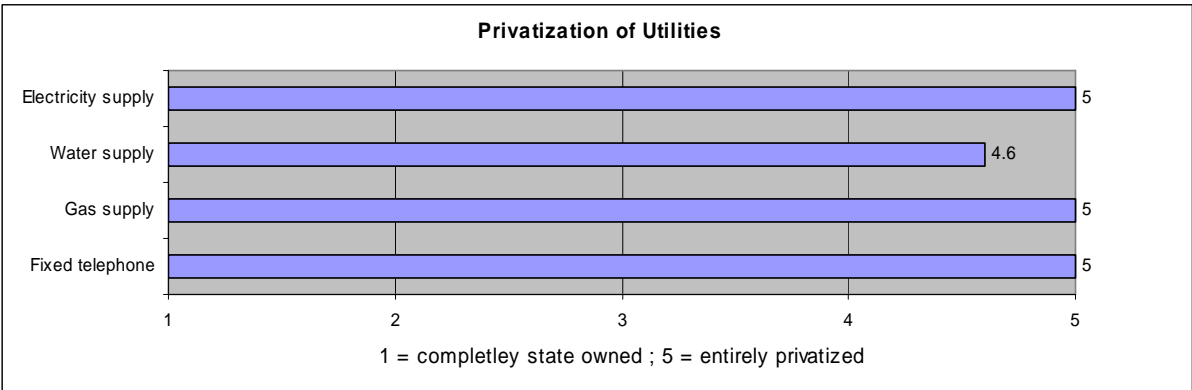
When the Labour Government arranged the sale of some of the state's shareholding in British Petrol in the early 1970s, this sale was solely enforced by budgetary pressure and did not reveal a belief within the government that state industries should be privatized. In fact, the same Labour Government nationalized two other sectors at this time, that is aerospace and shipbuilding. Only with the election of the Thatcher Government in 1979, did a fundamental strategy change occur within the government towards the privatization of state owned enterprises. Revenues from privatization reached a peak in the early 1990s. When in 1997 a new Labour Government came into power - despite promises when in opposition to reverse at least some of the privatizations - this government has sustained its own, though much smaller-scale privatizations, especially in the form of public-private partnerships (Parker and Hartley, 2003). As a result, all the respondents claimed that the privatization of the four utilities that were discussed is nowadays fully accomplished. Considering the liberalization of the four sectors nearly half of the experts indicated that markets were absolutely open, with the one exception of the water sector. The reason, that in the latter case laissez-faire economics are hard to establish, is mainly one of technological issues. Since the privatization process in the

United Kingdom is largely over, much can be learned from successful projects but also the failures that have been made so far.

The privatization of British Telecom (BT) started in 1984 with the sale of more than 50 percent of the shares. The remaining state holdings in the company were sold in 1991 and 1993. All of the experts agreed unanimously that BT is fully privatized today. Apart from 2 respondents, all experts agreed that the landline telecommunication market is very much liberalized.

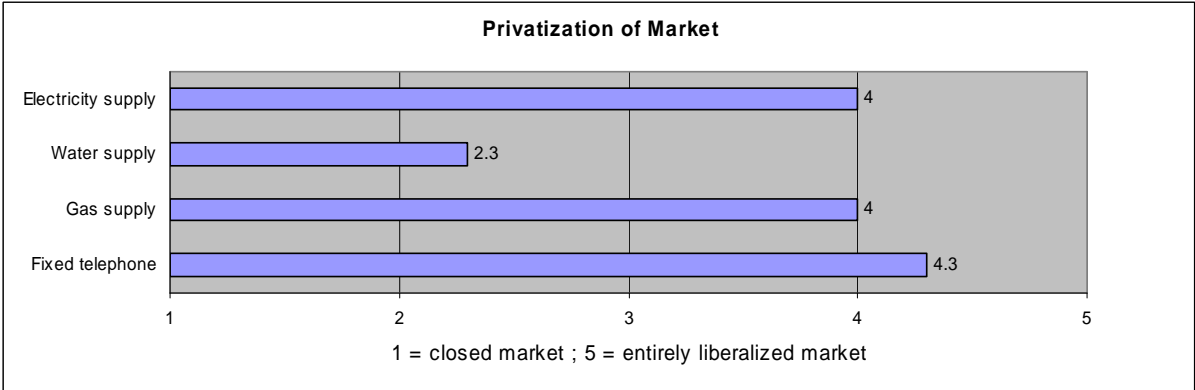
The privatization of British Gas (BG) started with the 1986 Gas Act, which initiated the privatization of the company through the issuing of shares on the London stock market. While all but one expert claimed that BG is fully privatized, it was objected by three out of eight experts that the market is fully liberalized today. The 1990s lead to a so-called dash for gas, during which the use of coal was reduced in favor of gas fuelled generation. This trend was aggravated by the privatization of the National Coal Board and the Central Electricity Generating Board. The competition within the energy markets was facilitated not least through the availability of cheap gas from the North Sea. As a result all experts found the energy sector to be fully privatized, while a majority agreed that the market is nowadays widely liberalized.

Graph14: Current state of privatization according to British experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 15: Current state of liberalization according to British experts/stakeholders



Source: Ifo interviews on privatization 2007/8

**5.5.2. Present Driving and Retarding Forces**

A majority of the experts claimed that political parties or interest groups did not slow the privatization process down in the last years, while three interviewees stated the opposite. According to the opinion of the later, consumers and unions stopped the privatization in the case of Royal Mail and the National Health Service (NHS). The arguments that were put forward in these two instances have to do with safety and universal access as well as the loss of jobs and the national heritage.

**5.5.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

Half of the respondent argued that the government influences in one way or another privatized firms. Almost all of them agreed that pressure is exercised through regulators or law. When it comes to market entry barriers concerning foreigners, none of the experts found neither operational nor financial market entry barriers established in the United Kingdom. When asked whether any type of investor appears to be less suitable to manage a privatized company, concerns were stated with regard to foreign public investors – in particular Gazprom, Electricité de France and Gaz de France were mentioned. The reason for this attitude was that some experts feared that a foreign investor cannot be made accountable if it does not fulfill a contract. Other interviewees claimed that a particular type of investor would not be more or less desirable as long as there are many competitors. For this reason all but one respondent indicated that foreign investors should not be constrained in any way, primarily as

such a policy has been regarded as unrealistic in Great Britain. The majority of the respondents further noted that the corporate governance of companies remarkably improved after privatization. However, two of the experts were stating the opposite, namely that not much has changed. While the former group claimed that the transparency improved, proper accounts have been published and firms now state a clear objective, one interviewee argued that the transparency of the firms worsened.

As regards the final question of this section of the questionnaire, which asked whether the experts would support or object the separation of the network infrastructure from the service provision, there was no clear cut answer to this issue. Though most of the experts wanted the network to be unbundled, concerns were expressed in the case of railway service providers and the Network Rail Infrastructure Ltd. as well as private water providers. Most of the interviewees argued that the unbundling and the consequent privatization of the network providers was a disaster in the case of water and railways. By relating unbundling with privatization most experts stated, that if accountability was missing and the right incentives to invest in the infrastructure were not established, the unbundling of network industries in all sectors is doomed. Although the gas, electricity and telecommunication sector were mentioned as positive examples, where the unbundling was rather successful in the United Kingdom, the disappointment in the case of water and railway were mentioned again and again. As prime reasons why the unbundling and the subsequent privatization of the network infrastructure did not work, the following two were named. First, it was stated that simply too many interests were involved and consequently there was and is no clear responsibility regarding investments. Secondly, it was argued that in the case of Railtrack many contracts were made by accountants, which were more concerned about the legal agreements than about the incentive structures that resulted from them.

With regard to the timeframe a regulatory authority should have, the opinions of the experts largely diverged. Some of the interviewees stated that in the case of natural monopolies competition would never be self-enforcing and furthermore a regulator is needed to set-up certain contracts. Others mentioned the political economy literature according to which bureaucracies have a natural tendency to expand and continuously engage in activities in new areas. Overall there was no agreement whether regulators in the United Kingdom work effectively or not.

#### **5.5.4. Winners and Losers of Privatization**

As regards beneficiaries and losers of the privatization process in the United Kingdom, the largest winners were according to the statements made the financial sector as well as the large consultancies. They gained through huge mergers and acquisitions as well as technical assistance projects. Surprisingly, not one single expert indicated that the employees benefited from the privatization of the utility sector, some however clearly stated that this group lost from the developments in the last three decades. The arguments that were put forward did not only mention that on net workers lost their jobs, but that they are in some cases worse paid and lost job security. On the contrary there was a broad consensus that shareholders, senior managers and consumers benefited from the privatization of the large utility providers. One interviewee mentioned that the unions were big losers as the degree of unionization degreed from more than 50 percent in the early 1980s to nowadays less than one fifths of the active labour force.

As a corrective measure a windfall tax was implemented by the Labour government in the year 1997. The tax had the aim to tax the excess profits of the privatized utilities and reflected the belief of the Blair government that the “family silver” had been sold too cheaply. Among the firms that were affected are the British Airports Authority, British Energy, British Gas, British Telecom, National Power, Northern Ireland Electricity, Powergen, Scottish Hydro, Scottish Power and Railtrack, the regional electricity companies and the privatized water and sewerage companies.

#### **5.5.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Price Levels and Services**

The consequences of the privatization process as assessed by the British experts are relatively straight forward. Apart from the water sector nearly all respondents stressed that competition is indeed in place in the utility sectors. In the gas, electricity and fixed telecommunication sector the business efficiency of the former incumbent improved and prices plunged after the privatization took place. Nevertheless, many of the experts claimed that these improvements are mainly due to the regulation of the market, which established competition, and are not the

result of privatization process as such. The opinions expressed are also in line with Parker (2004), who argued that the liberalization of the markets brought the achievements in prices and efficiency and that it was not the privatization of assets alone. Overall there was a broad agreement among the respondents that privatization led to a significant improvement in the service quality that utility providers offer today.

The respondents disagreed largely about ethical issues as regards the privatization of the four utilities that have been discussed. However, the sector that was most distinguished from the others is water supply. Some experts mentioned that it is a very essential good that should respond to public needs and not to market forces, if the two are in conflict. Apparently there are regulations in place to avoid that poor individuals are cut-off from electricity, gas or water in case they cannot afford to pay their bill during the winter.

#### **5.5.6. Public Opinion towards Privatization**

Concerning the current debate on privatization in the United Kingdom, experts agreed that three topics are predominant in the public debate. These are consumer welfare, efficiency and economic order. According to the statements made, the British society is concerned about the National Health Service being bought by a foreign investor, the safety of the rail system and the accessibility of the utility providers, especially if these are not domestic firms. Finally none of the experts mentioned that employment is an issue, while three have been explicitly stating that it is not.

#### **5.5.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

From a retrospective point of view, almost all British experts explained that privatization was a success in the United Kingdom, while only one interviewee contradicted this claim strongly. Nevertheless, all interviewees agreed that the implementation of privatization went wrong in the case of railways and water supply, but was rather successful in the case of electricity, gas and telecommunication. As a result of the disastrous Railtrack privatization, half of the respondents stated that the rail network should be renationalized. Some others claimed that this should also occur in the case of water supply and hospital cleaning. The experts further suggested that Royal Mail, parts of the military as well as real estate and buildings owned by

the state, should be privatized in the near future. One respondent mentioned that the welfare state in general should go further steps towards privatization.

## **5.6. Valuation of Privatization Issues in Germany**

In the case of Germany interviewees represent the following stakeholders: Industry, academia, regulatory authorities, consumer associations and the public sector. In total eleven face to face interviews were carried out.

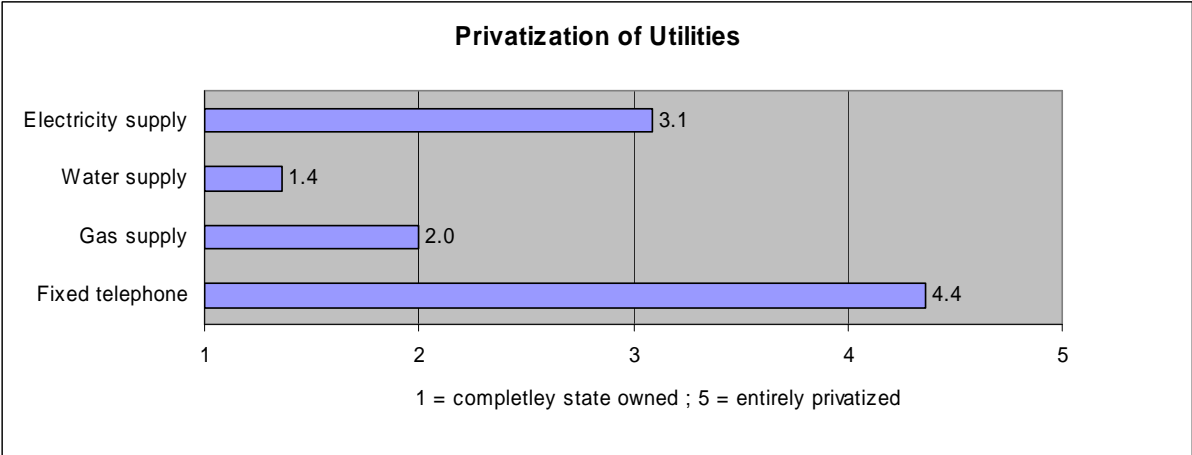
### **5.6.1. The Current State of Privatization**

Germany officially started the privatization process in 1983, when the CDU-CSU/FDP coalition led by Helmut Kohl came into power. In 1983, public enterprises accounted for 9.6 percent of GDP value added. Between 1986 and 1989 the government started with the sale of shares of the automobile producer Volkswagen, the energy and chemical firm VEBA and the airline Deutsche Lufthansa. Since 1989 the German postal and telecommunications sector has been increasingly liberalized. The former postal service was split into three parts: Deutsche Post AG, Postbank AG, and Deutsche Telekom AG. After the fall of the Berlin Wall and the collapse of the East German Communist regime in 1989 the policy agenda of the Federal Republic changed. The Trust Agency (Treuhandanstalt) was established to head the privatization of the nearly 8000 formerly state owned enterprises in East Germany. In 1994 Kohl formed his fourth subsequent government, in the middle of economic difficulties due to recession and unexpected costs of unification. The privatization process gathered momentum during the second half of the 1990s. In 1996 revenues of privatization increased about 89 percent with respect to the previous year, totalling over US\$13 bn, mainly raised through the public offer of 26 percent of capital of Deutsche Telekom. In the subsequent two years the process slowed down, especially in the electoral year 1998 that saw Gerhard Schröder come into office with a coalition of the SPD and the Green Party. It was under the government of Gerhard Schröder that the revenues from privatization reached top values since the beginning of the privatization process. The revenues accounted for around US\$20 bn each year in 1999 and 2000. Among the most relevant transactions of this period that mainly involved the

privatization of utilities were the two partial sales of Deutsche Telekom, the initial public offer of Deutsche Post, and the sale of Berliner Wasserbetriebe water company. After these privatization milestones the process decreased abruptly, as was the case in other European countries.

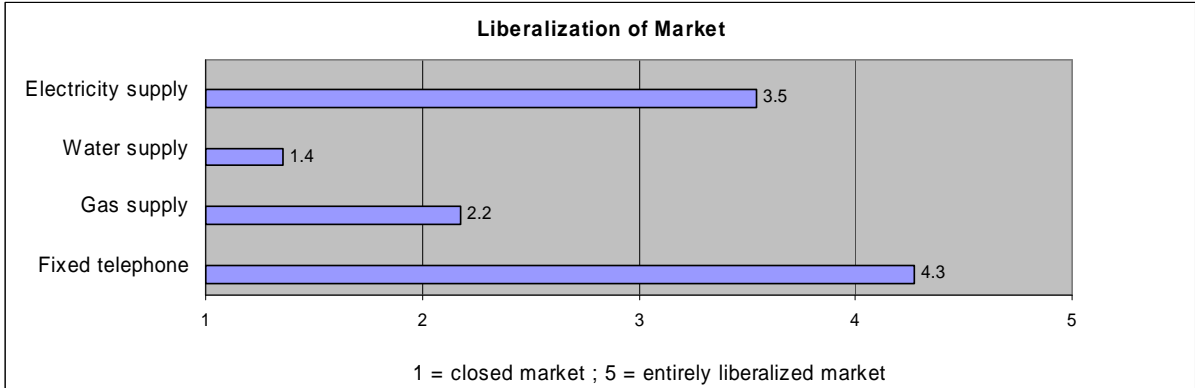
According to the interviewed experts the current extent of privatization and liberalisation of utilities in Germany has resulted in different outcomes depending on the sector. On the one hand, all interviewees agree that the privatisation and liberalisation of the telecommunication sector has already achieved a very high level. Currently, the German government still has a direct stake of 28.33 percent in Deutsche Telekom AG. On the other hand, there is nearly a consensus among the experts that water supply has neither been privatised nor liberalised to a great extent so far due to the natural monopoly character of the utility. Questioned about the current state of privatization in the gas sector the interviewees expressed the opinion that the liberalisation and privatization of the gas sector has only seen modest progress. Most of the interviewees consider the electricity market to be more privatised and liberalised than the gas market. However, competition is still limited in the electricity sector due to the oligopolistic market structure and the regional dominance of big utility providers such as Eon, RWE, Vattenfall and EnBW. Furthermore, local distribution in the gas and electricity sector is still mainly hold by the public authorities.

Graph 16: Current state of privatization according to German experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 17: Current state of liberalization according to German experts/stakeholders



Source: Ifo interviews on privatization 2007/8

**5.6.2. Present Driving and Retarding Forces**

According to our respondents, the political parties have rather slowed down the privatisation efforts over the last years. Moreover, two thirds of the experts questioned hold the opinion that political parties have hindered the progress of privatisation and liberalisation efforts. However, the German experts disagreed with regard to the attitudes towards privatization and liberalisation of the respective political parties in Germany. On the one hand, four interviewees stated that the left parties, mainly the SPD and the green party, have not been in favour of liberalisation. On the other hand, two experts emphasized explicitly that neither the trade unions nor left parties have been a hindering force of the privatisation process. Interestingly, only two out of the eleven consulted experts argued that the conservative parties have been supportive of liberalisation. An interesting perspective was given by two experts who stated that support of the privatization process is not a question of being more leftist or centre but varies distinctively between the different political administration levels. In fact, communes and lower levels of the administration seem to be more critical towards privatisation than higher levels, especially the federal government of Germany.

**5.6.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

Most interviewees affirmed that the government still influences the former incumbents. According to the experts, it is important to stress that the government not only has a strong influence on companies that underwent a formal privatization, in such a case only the legal

form of a company changes from a public entity to a private entity but the state remains the main shareholder and keeps full control over the company, but that this is also true for most of the material privatizations, where the actual ownership is handed over to the private sector. The experts expressed the opinion that the state remains significant influence over the companies through informal networks between politicians and the private sector and the appointment of former politicians as members to the board of directors. According to some experts voting rights are also a major source of influence over privatised companies. Furthermore, subsidies are used to influence companies in the sector of public transportation, especially the railway industry. However, according to the interviewees, subsidies are not a big issue in the industries discussed above.

When asked about the ability of foreign investors to invest in the privatized incumbents nearly all of the respondents argued that investors have already free market access to the telephone sector. Regarding the electricity sector the opinion of the experts diverged. Most interviewees expressed the opinion that although no formal barriers exist for foreign gas and power suppliers to enter the market in Germany there are currently still problems which are retarding possible market entry and therefore hinder competition. One expert mentioned capacity shortages in the international electricity grid as such a problem. However, another expert argued that domestic investors are facing the same entry problems as foreign companies. Finally a third expert after all recognises current competition improvements due to a better performance of the regulatory authority, thus enabling the entry of competitors into the market.

When questioned about their opinion regarding different types of investors which might hold a 25 % stake or more in the former public monopolist the interviewees stated that this topic is highly controversial. Especially big foreign enterprises which are de facto under control of foreign governments evoke concerns. One expert mentioned the Russian enterprise Gazprom as an example in this context. The experts expressed the concerns that such foreign enterprises might undertake their investments with political interests in mind and not only out of economical considerations. Thus, the dependence of Germany from other countries could grow. With regard to private foreign enterprises the interviewees expressed less concerns. One interviewee argued that privately hold foreign companies will not abuse their stake in the former incumbents to exercise political pressure because in this case, they would pay a high financial price. However, according to another expert, a major concern is the possible abuse of hidden reserves by the foreign company as a means to generate fast profits. According to

one expert railway tracks could prove to be such a hidden reserve and therefore have to be dealt with great care in the privatisation process. Moreover, the experts argued that foreign investors can have a positive impetus on the German economy. A positive effect of the engagement of foreign companies in the former incumbents is the possibility of a transfer of know how and managerial skills. Furthermore, the engagement of big international providers in the German utility sector can lead to synergy effects and a higher level of efficiency.

Nearly all experts claimed that the privatization of network services should be separated from the privatization of the network infrastructure. However, two of our interview partners expressed their concerns due the negative experience of the railway privatisation process in the United Kingdom and due to security concerns. According to the interviewees, the main positive aspect in favour of the separation of network infrastructure and service is the improvement of competition. Concentration of both infrastructure and service in the hand of one company weakens competition as the owner of the infrastructure can impose high taxes for the use of his infrastructure on his competitors. Additionally, integrated companies have a competitive advantage compared to pure service companies because they obtain lower credit rates due to a higher capital stock. With regard to the most frequently named example the German Railway company “Deutsche Bahn AG”, many experts recommend to keep the railway system in the ownership of the state. If the infrastructure meanwhile is privatised, the point of view of almost all experts is that the existence of a regulatory authority is absolutely necessary to protect competition. According to the interviewees the performance of regulatory authorities to enforce competition varies across the different sectors. The experts consider the regulatory office to do a good or very good job in the telephone market. However, the regulatory authority is said to ensure competition only partly in the electricity and gas sector. Two experts made the suggestion to integrate the regulatory authority (in Germany “Bundesnetzagentur”) in the general competition authority (“Bundeskartellamt”). Others argue that it would be recommendable to exercise the regulation from the European level as national regulatory offices tend to privilege former incumbents against their foreign rivals. Finally, this part of the interview was concluded by asking about the public good character of the sectors. Almost all our interview partners coincide that the security of supply of water is untouchable. The public responsibility to ensure the supply of electricity and gas is not considered as crucial as the water supply. According to our experts the telephone sector is the least sensitive product as more substitutes are available. Another expert argued that all the services can be offered by private enterprises while other interviewees are concerned about a

deteriorating supply situation due to the privatisation efforts. The German Railway which has shut down several lines was mentioned as an example for a deteriorating supply situation.

#### **5.6.4. Winners and Losers of Privatization**

The interviewees were asked whether the privatization of the utilities was beneficial or harmful to individual parts of society in Germany. The opinions of the interviewees differ regarding the consequences of privatization on the employees. On the one hand, many experts stated that the situation of the employees has deteriorated due to job reductions and more pressure on the workplace. On the other hand, three experts claimed that employees are beneficiaries of privatisation. One expert especially emphasized the positive long term effects of privatisation for employees. Furthermore, the majority of our interview partners coincide that the managers have profited from privatisation. Surprisingly even more, in total nine out of the eleven experts argued that consumers have benefited from privatisation, especially due to the price reductions in the telephone sector. One expert stated the loss of the share of the Deutsche Telekom as an example where shareholders clearly lost. Regarding the taxpayers two experts hold the opinion, that if the German railway will be privatised according to the current strategy the state and consequently the taxpayers would lose due to the high amount of sunken investment in the infrastructure. In spite of the fact that privatisation process has created beneficiaries and losers, the German government has not been very active in equilibrating those effects. The German government has not created a universal fund to guarantee a universal service provision, it is only giving public subsidies, e.g. in the sector of public transport. However, one expert explained that job guarantees have been established in some former public enterprises. On the other hand, two interviewees explicitly expressed the opinion, that public action to help losers of privatisation wasn't necessary.

#### **5.6.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Price Levels and Services**

When asked about the consequences of privatisation and the performance of former incumbents, nearly all of our interview partners stated that efficiency has improved in the telecommunication sector. Moreover, service has improved and the prices of the former monopolist "Deutsche Telekom" have decreased considerably through privatisation, although this might to a large extend be due to technology effects and not due to the privatisation

efforts. However, the question if the “Telekom” is already competitive with regard to prices is much more controversial. More than half of the interviewed experts denied the competitiveness of “Telekom” in the domain of prices as well as in the domain of its services.

With regard to the gas and electricity supply the situation described by the experts is completely different. Although efficiency of the privatised enterprises might have grown, only two persons stated that electricity prices of the former public monopolists have fallen. Indeed, interview partners mentioned that due to commodity price effects and changes in energy taxation the question is hard to answer, but the general perception was that prices might have risen due to the privatisation of this sectors. With reference to the quality of service of the former incumbents the situation is similar with about fifty percent of the experts affirming service improvements.

Furthermore, we discussed the topic of corporate governance. Nearly two thirds of the experts think that the corporate culture has improved in the former incumbents. However, the interviewees stated that the improvements in the management and corporate culture have rarely been fundamental. According to one expert the management incentives should be adapted in order to change management priorities from short term success to long term growth and profitability.

#### **5.6.6. Public Opinion towards Privatization**

The arguments put forward by the opponents of privatisation according to our experts are numerous and usually include the “public good character of services”, the aggravation of services, the reduction of jobs, low salaries and the destruction of nature. The interviewees expressed the opinion that the German public is very concerned about the security of supply of the former incumbents. The power breakdown in the winter of 2005/06 which was received by the public as being related to the privatisation process was given as an example that triggered concerns about the security of supply in the broad public. Furthermore, a second argument which is often brought up by privatisation opponents seems to be the desire within the government to create strong National champions. In that regard the opponents still consider the state to be more competent and its influence as a necessary predicament for the creation of national champions. According to the interviewees the privatization of the utilities was mainly driven by the need to consolidate government revenues through the sale of public

enterprises and through a possible increase of future tax revenues as a consequence of the improved efficiency of the former incumbents.

### **5.6.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

In spite of reservations against privatisation and liberalisation projects the majority of experts indicated that they judge the general feeling within the public in Germany to be positive. However, as one expert stated a problem from the point of view of the public is that the advantages of privatisation are diffuse, while its risks, like mass dismissal of employees are visible at once. According to the experts that have been interviewed, the prime issue in the German society concerning privatization is the possible loss of jobs due to privatization efforts. Furthermore, fifty percent of the interviewees argued that changes in the economic order, which are considered as unsocial by the public, are an important aspect in the privatization debate. Although the experts themselves regard the consumer as beneficiaries of privatisation, they claim that within the public many people fear a deterioration of the supply security.

The interview partners made several suggestions with regard to privatisation policy in the future. An important topic is the need for the former incumbents to become more transparent. One expert stated the electricity price system as an example for a lack of transparency. Furthermore, ongoing steps in the European harmonization process are needed. One interviewee favoured the creation of a European energy authority, which could replace the national survey organisations. Moreover, the experts agreed that it is the duty of the state to set thorough supply and quality standards. Questioned about the future prospect of privatization and liberalisation projects in Germany the experts regarded the privatization of the German railway to be the hottest topic. In general, most of the German experts agreed with railway privatisation. However, the experts did not coincide on the question whether the infrastructure should be privatized or remain in the hands of the government.

## **5.7. Valuation of Privatization Issues in Austria**

Three interviews were carried out, all of them with specialised experts from the academia (of two Universities and one independent research establishment).

### **5.7.1. The Current State of Privatization**

Until the eighties in Austria the share of the state owned sector in the economy was larger than in most European countries. Historically this can be attributed to the after war situation (1945 Sowjet occupation and later neutrality status negotiated with the Sowjet Union). Between 1946 and 1947 the Austrian government implemented two nationalization programs which brought the key industries including utilities and the financial sector under state ownership. In general, the SOEs proved to be profitable enterprises until the mid seventies. However, due to the strong political impact on management positions and increasing international competition the SOEs became an increasing financial burden for public budgets. In the eighties the conservatives (ÖVP) took over Government and initiated a large scale Privatization programme first in the industries and later in the other sectors. Trade Unions and partly the Socialist Party opposed publicly the Programme but in many cases tolerated the privatization activities. In preparation of Austria's EU access und under the coalition Government of the Conservatives and the Liberals (ÖVP/FPÖ) privatization was intensified. The privatization was largely implemented by a public Holding, the Austrian Industrial Holding AG (ÖIAG). However, especially in the utilities sector important enterprises remained under regional and municipal control.

Today, Privatization of the industrial and financial sector can be considered completed. The new socialist Government shows no further privatization activities in its programme, although sales of remaining public Telecom shares as well as of the Austrian Airlines may take place some time in future.

The privatization process in Austria by law forced the adequate consideration of employees and the national interests of Austria. No major social or political conflict problems could be observed during the privatization activities.

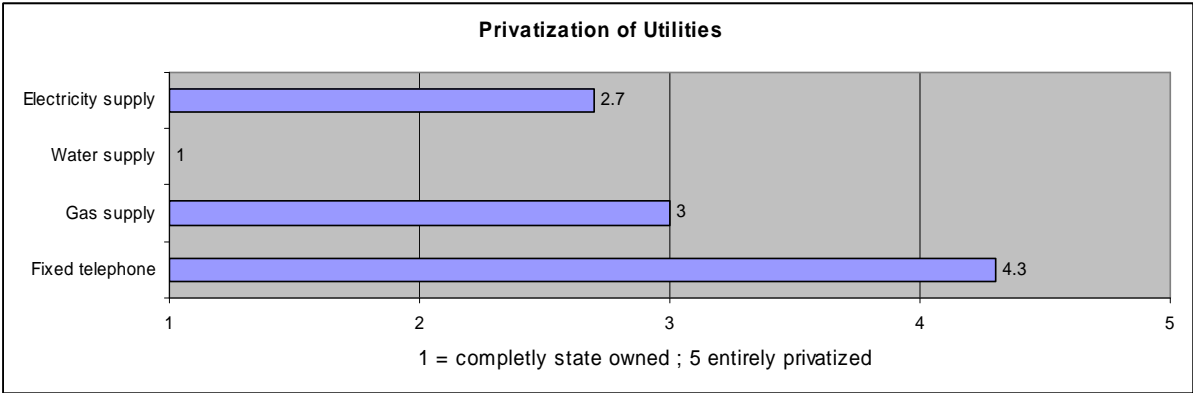
All three interviewees confirmed that in Austria practically no major conflicts could be attributed to the privatization process. The secret for this, they explained, is the political and interest group "consent culture" to which all stakeholders adhered to. The experts stated that there was a huge difference between the formal structure of the utilities and their existing informal structure that dominates the way day to day business is being conducted.

Political impact is still strong in consent finding and strategic policy making, which is generally accepted by stakeholders and the public.

However, according to the consulted experts some liberalization problems do remain and some considerations are made among stakeholders towards improved regulation.

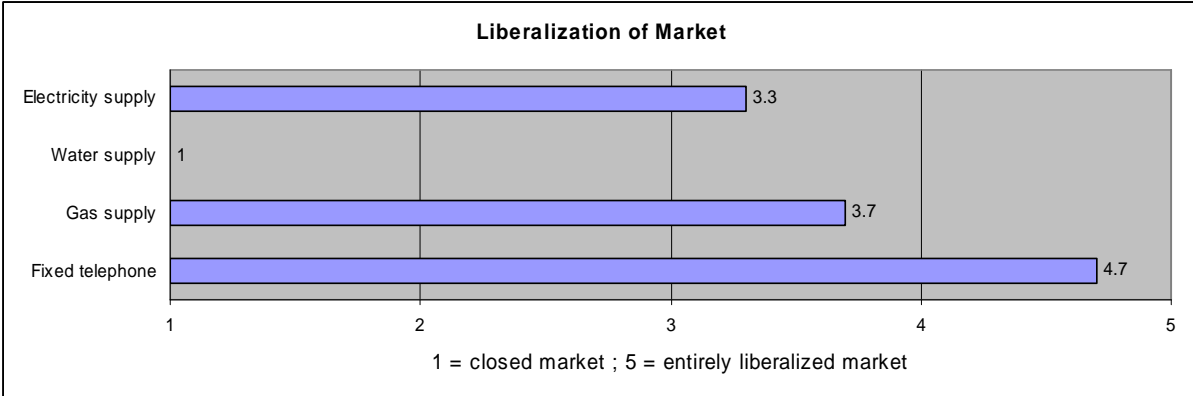
As far as the utilities are concerned the experts state unanimously that water supply is not privatized and no major stakeholders would favour such a development. They also pointed at the fact, that electricity supply is widely under regional control and some regional authorities are very resistant to privatization (e. g. especially in Niederoesterreich much more than in Vorarlberg). On regional levels, they tell, policies towards privatization do not necessarily follow party policies at national levels.

Graph 18: Current state of privatization according to Austrian experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 19: Current state of liberalization according to Austrian experts/stakeholders



Source: Ifo interviews on privatization 2007/8

**5.7.2. Present Driving and Retarding Forces**

Liberalization requirements at present are slowed down by vested interests of the public sector and by regional political structures. The experts stated that there are currently no major

driving forces that foster further privatization or liberalization efforts. At the moment the Present socialist Government abstains from any action. According to the experts there is no more much articulated need to take up privatization and liberalization issues, neither in political groups nor in the media. Security of supply is a wide spread argument to refuse further action and often negative privatization experiences in Britain and the USA are quoted in support of the reluctance towards further steps towards privatization and liberalization. The experts themselves do not see important needs for further privatization either. They stated that further progress towards a more competitive market structure is most likely to deliver positive results. However, they feel that the general public does not seem to be very concerned about this.

### **5.7.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

Liberalization and competitive structures have been, according to the interviewees, successfully achieved in the formerly SO industrial and financial sectors.

However, this does not hold for the utilities sector. The experts stated that it is important to distinguish between large scale users of utilities and the consumer households as well as SMEs. Large scale enterprises are not dependent on individual national utility providers (except water), due to their large volume of consumption they can use international competition structures and choose out of a variety of providers. Especially in gas and electricity supply Austria is split into two market systems: On the one hand, consumer households and SMEs face a monopolistic market structure on the other hand large scale enterprises reap the benefits of a competitive market structures. This may also explain that the enterprise stakeholders and their lobby organizations in Austria are not a driving force for liberalization at present. Monopolistic structures, therefore, do exist for the “small citizen” but not for the powerful utility users. Furthermore, Trade Unions, explain the experts, are more interested in employment privileges than in de -monopolization. Dis-bundeling of physical nets and service operations is considered important but in cases of implementation this was not effectively achieved as far as more competition is concerned. The operators managed to indirectly control the net operators.

There are no outspoken or formal investment policies in Austria as far as types of domestic or foreign investors are concerned. But Austrians, all three interviewees agreed, are very cautious when it comes to foreign dependence. Informally and very much so on regional

levels a strong political control prevents “too much” foreign influence in privatized enterprises. This, they state, is in consent with practically all stake holders.

However, investors from EU countries are preferred to non EU investors. One interviewee stressed that we currently face EU electricity market which “paradoxically” is not regulated EU wide but by each individual country. As a result the experts explained that the country currently faces undesirable structural distortions and heterogeneous competition situations within the EU.

Austria, of course, like other countries, has introduced sector specific regulatory agencies. However, the experts claim that these are not independent since they are controlled by the Ministry of Economic Affairs which in turn is affiliated with SOEs or formerly SOEs’ interests. Furthermore, many political appointees are part of an informal network with the former SOEs. The sector specific regulatory system, according to one expert, has an additional deficiency. Due to its very heterogeneous structure regulations become weak and less transparent. The expert, therefore, pleads strongly for a more uniform regulatory framework. All interviewees stated that regulatory authorities have to be permanent institutions in the utilities sector (for ever, at least in the foreseeable future).

#### **5.7.4. Winners and Losers of Privatization**

The “Austrian Model”, with its inherent focus on social partnership and consent, as the interviewees named it, improved the outcome of the privatizations significantly for the employees. As a result the employees can not be considered to be losers of the privatization efforts. In some cases privatizations had negative outcomes for some parts of society, for example managers appointed by the political class or consumers due to deficiencies in the competitiveness of the energy sector. Winners are undoubtedly the Governments due to a positive effect of the privatization on the state’s budgets as well as the taxpayers. In the utilities sector Telecom supplies improved and prices fell considerably. Telecom users have definitely been beneficiaries of the privatization process. Further more the business community and especially large scale enterprises benefited. But as far as energy is concerned the SMEs and household consumers lost according to the views of our interview partners.

### **5.7.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Price Levels and Services**

The unanimous judgement of the three interviewed experts was that the internal efficiency and general competitiveness of formerly SOEs has improved due to the privatization efforts. Furthermore, privatizations have resulted in a better corporate governance. However, this has not necessarily led to competitive and efficient market structures for the user of utilities– this is especially true for ordinary consumer and small entrepreneur in the energy sector. Moreover, services have improved with telecom but the experts had reservations regarding gas and electricity. No change (but also no privatisation) occurred in the water supply sector. Austria shows a typical picture regarding the outcome of privatizations on prices. Prices fell for telecom services, initially probably also for gas and electricity but re-monopolization of privatized or partly privatized firms reversed this trend according to the informants. Political networks with former SOEs at various levels prevent competitive market structures for households and small enterprises.

### **5.7.6. Public Opinion towards Privatization**

According to the experts, privatization in Austria has become a very minor issue in the media and the public discussion. Most projects have been completed and the general attitude is “be careful with further privatization, there are bad examples in England and the USA”. There is a general agreement that water supplies should not be privatized. Privatization in Industries and Banks is widely accepted and generally considered a success. The same is true for the telecommunication sector. Austrian citizens do not want to become dependent from enterprises or investors abroad, probably because Austria is a small self conscious country and people consider it to be highly susceptible for foreign intervention. This attitude, of course, is detrimental for creating more competitive structures in the energy supply sector

### **5.7.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

All three experts agreed that privatization in Austria by and large was a success. It is the energy sector which only partly showed success and partly created new problems. In general, they state unanimously, Austria is an independent country and “proud” of its independence.

There is a national consent that independence must be of priority concern – also in privatization programmes. On this matter the Austrians are not willing to change their position. Apart from that matter the experts would support a new impetus for more EU harmonization of the regulatory frameworks especially within the utility sectors. The interviewees regret that internally Austria lacks driving forces that would foster the creation of an effective competitive structure in the energy sector.

## ***5.8. Valuation of Privatization Issues in Italy***

In six interview events nine individual partners participated. They represent the academia (4), private finance institutions (3), public finance institution (1), Competition Authority (1) and an enterprise association (1).

### **5.8.1. The Current State of Privatization**

Italy's economy had traditionally a strong public sector. The state managed its various SOEs through its industrial holding Istituto per la Ricostruzione Industriale (IRI). The IRI played a crucial role during the economic boom years of the 1950 and 60s. The state's field of activity through its SOEs involved nearly all branches of economic activities, but was especially strong in credit, insurance and manufacturing.

after the success of SOEs through the 60s and 70s the state owned enterprises started to experience difficulties and from the 70s on increasingly became the source of production inefficiencies and misallocation of resources. The SOEs lacked incentives to operate efficiently and failed to react to the changes in their respective markets. This development has largely been attributed to the fact that non-economic goals such as the preservation of jobs and sustaining investment levels were put above corporate policy considerations in the public enterprises. As a result Italy faced a vast and very deficient public sector. In 1992 the three main conglomerates (IRI, ENI, and EFIM) employed over half a million workers altogether.

In 1991 the State owned twelve out of the twenty largest Italian non-financial firms. At the same time, about 90 percent of total financial investment and 80 percent of total deposits was ensured by public credit institutions. Due to the pressure on the country's budget Italy became one of the first European countries that followed the British economic policy of divestiture.

However, despite some consolidation during the 1980s the financial position of the state's industrial holdings (IRI, ENI, and EFIM) further deteriorated. The situation became critical for EFIM and the non-financial section of IRI. EFIM's net financial debt in 1991 was twice larger than net sales resulting in a total loss of its own capital, prompting its liquidation in July 1992. In the light of this development Italy started a very ambitious privatization with the beginning of a long lasting process of denationalisation of IRI. Until today, Italy has been able to raise over US\$160 (constant 1995) bn. through privatization proceeds since it initiated its divestiture process in 1985. From the first partial sales in 1985 to date, the country has been able to raise through privatizations over US \$ 160 bn (constant 1995). Moreover, Italy accounts for the largest amount of revenues among all European countries (excluding the United Kingdom), representing respectively 19 percent and 8 percent of the area total revenues and transactions. The privatization efforts began during the 1980's with scattered sales. The first large scale privatisations date back to the year 1992 with the sale of the IRI's subsidiaries Sirti, STET and Alitalia. The process gained momentum under the increasing pressure of the European Commission against state aid to ailing firms, and the need to meet Maastricht convergence criteria. In 1992 the goals of the privatization process were defined by the Amato government:

- improve corporate efficiency
- increase the degree of market competition
- widen financial market and promote the internationalisation of the industrial system
- increase fiscal revenues and reduce public debt.

Italy pursued a more flexible approach towards privatization than most of the other European Union countries by granting the management of IRI and ENI a high degree of autonomy over the operational restructuring process of their holdings and subsidiaries. Furthermore, in 1993 in order to ensure a high degree of transparency of the privatisation process the Comitato Permanente di Consulenza Globale e di Garanzia composed by the General Director of the Treasury and four independent experts was established. In 1993 and 1994 three major banks - Credito Italiano, Istituto Mobiliare Italiano and Banca Commerciale Italiana – and INA, the second-largest insurance company, were sold through public offers. Between 1997 and 1999 privatisations accelerated dramatically. Major transactions include:

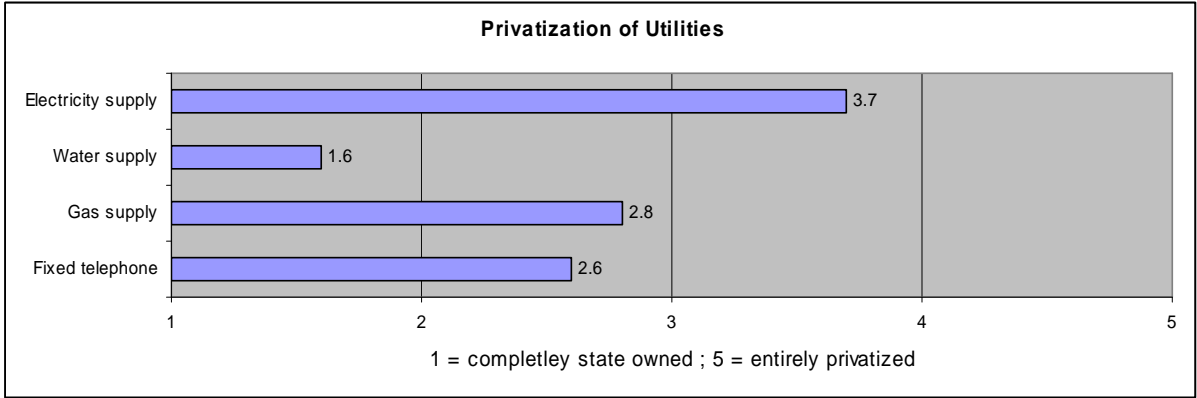
- the sale of 12.5 percent of capital of ENI in 1997 and 1998, worth over US\$7 bn and US\$6 bn respectively;
- the public offer of Telecom Italia – 44.7 percent and around US\$11 bn raised
- the sale of Banca Nazionale del Lavoro occurred in 1998;
- a private sale in November 1999 of Autostrade and a subsequent public offer of its 57 percent capital in December
- 1999 privatisation of ENEL - the electricity giant – that, albeit partial (32 percent of capital sold) is the world's largest initial public offer (IPO) at that time (over US\$17 bn).

In June 2001, following the electoral success of the centre-right coalition, PM Berlusconi announced the intention to further pursue privatization policy. As a result in 2003 the state sold its whole stake in Telecom Italia. In 2004, the government divested parts of its (indirect) holdings in SNAM Rete Gas, a subsidiary of ENI owning the gas network distribution system, and in Terna (ENEL's company owning the electricity grid), through a successful IPO. In October 2004 the MEF successfully completed the giant follow-on Global Offering for nearly 20 percent of ENEL share capital. The issue, comprising a large retail tranche and a placement to domestic and international institutional investors - raised some US\$ 9.5bn, representing the largest deal in the world of its kind for the past four years. In 2005, ENEL sold to Cassa Depositi e Prestiti (CdP) a 30 percent stake in Terna and in March a further 14 percent via an accelerated transaction. In July, the MEF completed the fourth tranche of ENEL: a 9.3 percent stake was sold, generating proceeds for over US\$4.9bn. The ENEL's US\$ 15bn sale of its telecom subsidiary Wind to Weather Investment, which closed during August after an extended struggle between competing bidders, was the largest privatization transaction in Europe for the second semester in 2005. In Italy as in most countries privatization policies are strongly influenced by the ruling parties and coalitions of them. A specific aspect of Italy's privatization is that a few families control large investment shares and therefore have to be considered important stakeholders of the privatization. A specific aspect of Italy's privatization is the impact of few families controlling large investment shares of the country and by this fact these families must be considered important stakeholders (operating more in the background) of the privatization process.

(operating more in the background) .In general, Italy follows some strong formal restrictions to maintain public control. The Treasury holds “golden shares” and more importantly, private shareholders are not permitted to combine their holdings (thereby increasing their voting

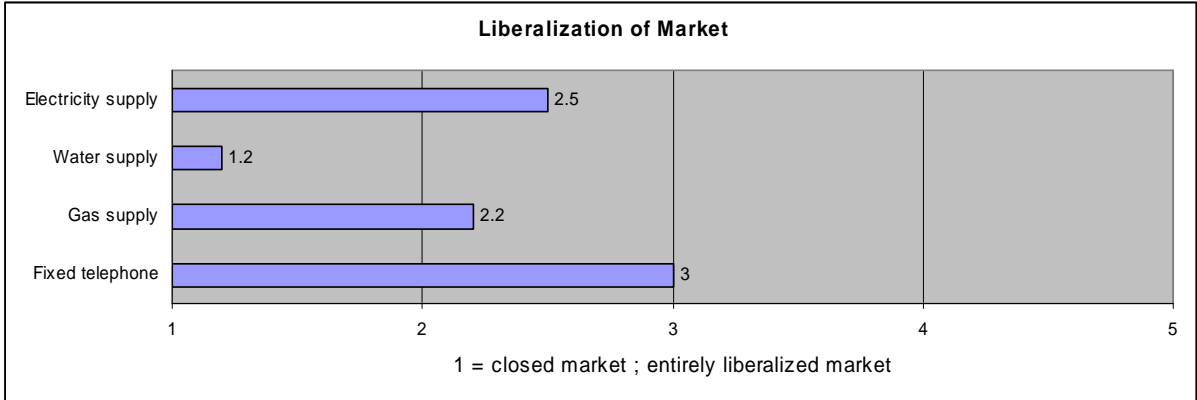
power). Furthermore, no single shareholder is allowed to keep more than 3% of the shares in the utilities. ENEL managed to control most of the electricity operations (generation, wholesale, dispatching). In the gas sector, although legally unbundled, a separate company of the ENI group owns and manages the network, enabling ENI to control large portions of the market in practice.

Graph 20: Current state of privatization according to Italian experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 21: Current state of liberalization according to Italian experts/stakeholders



Source: Ifo interviews on privatization 2007/8

**5.8.2. Present Driving and Retarding Forces**

The nine interviewees rather unanimously judged the telecom sector (including fixed telephone) to be the most advanced sector regarding privatization and liberalization efforts. They also stated that improvements in the liberalization of the electricity supply have been made. However, the judgment changed when asked about the privatization progress in the

remaining utilities. The gas and water sectors were considered least privatized and liberalized. The experts pointed out that liberalization of the gas sector has been fostered legally but that this has not yet been transferred into practice, since the shortage of pipelines and the existence of one degasification plant only, owned by ENI, provides the company with a technical dominance which can be seen as a means to establish monopolistic structures. In addition, major shares of gas and water supplies are often held by public local authorities, which are not interested in losing control over these important assets. Moreover, the position of former incumbents is judged to be strong in all utility sectors.

The interviewees expressed the opinion that in Italy the major privatization activities are finished. However, the experts stated that some fields of activity remain. The Government may still sell its remaining stake of ENEL and ENI shares and relevant reforms for privatization at local authority level are currently being discussed. Furthermore, the state may sell its remaining shares in Alitalia. Finally, the experts demanded more transparency regarding the price setting system in the telecommunication sector.

Currently, the driving forces behind privatization efforts are the public revenue institutions as well as some media (and the respective political forces behind), which point at corruption and nepotism in public enterprises and thereby create a widespread attitude that Government should withdraw from business activities.

But, there are also strong forces retarding privatization efforts such as local authorities, labour interest organizations, vested interests of the public and incumbent sectors. Somewhat unclear is the position of the “big families” who often exercise business activities irrespectively of public or private ownership. But once business privileges are established these stakeholders will (and do) carry out influence to keep structures unchanged as regards these privileges. Since these important family based business systems have a stake in politics and parties as well, influence, at least to some extent, can be directly exercised through Government. In Italy consumers are considered to be a weak power group regarding their capacity to articulate their interests.

### **5.8.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

Despite a legal framework which is judged to be rather liberal, the interviewees rated the problems regarding the competitive structure of the former incumbents as being most prominent, as reality differs to a great extent from this framework. In fact, in the gas, water and electricity sector monopolistic structures are a dominant feature. Even in the telecommunication sector the “last mile reach” and the strong market position of the former incumbent have resulted in the implementation of price policies without relation to free market structures. Furthermore, a situation, also observed in some other countries was mentioned, namely that large scale users of utility services face a different, much more competitive market structure, compared to smaller users. The reason for this, the experts explained, is their strong negotiation power. The experts stated that prices for big users have decreased due to privatization. However, except for prices of telecom services which decreased due to privatization (but also due to technical innovation as some explain), this has not been the case for small users

Experts expressed the opinion that networks after unbundling should remain under public control. In fact, this attitude was comparably strong. Obviously, the majority of the interviewed specialists were very sceptical about the maintenance and management policies if completely privatized.

Practically all experts agreed that privatization resulted in an improvement of business efficiency in all utilities sectors, except for water. Water systems in some areas are in a very poor state and services significantly deteriorated. However, not much privatization has taken place in the water sector yet.

When questioned about the current investment policies, regarding foreign investment in the former incumbents, most experts stated, that due to the 3% rule (not allowing one investor to acquire more than 3% of a company’s shares) Italy’s utility sector is judged to be protected from foreign investment. Therefore, foreign investors are not considered a “danger”. Actually this prevents foreign investment on a larger scale. Furthermore, foreign companies will face operational difficulties if they would access potential clients directly. This is true more so for the gas electricity and water sector. The experts stated that private strategic domestic investors

are highly desirable but most of the experts hold the view that the current system whereby licences for private operations are granted for a certain period is highly problematic. The experts pointed to the fact that this system is detrimental for maintenance, once the contract period is nearing its termination. One problem was seen in a system whereby licences for private operations are granted for a certain period only. This is detrimental for maintenance, once the contract period is nearing its termination. It was opted to abolish this system.

Italy, like all other investigated countries, has established regulatory authorities. Moreover, the interviewed experts consider them to be of great need and hold the view that the regulatory authorities should be permanent institutions. In this issue there was a high degree of consent. However, the judgement of their actual role in regulating the utility sector was rather negative. “Weak”, “un-experienced”, “large enterprise owners have a stake in the authorities”, “politically infiltrated”, “media often are owned by companies and therefore do not exercise a watch dog function towards their owner companies” were some of the comments underlying the ineffectiveness of the regulatory institutions in the opinion of the asked specialists.

Some experts explained that it could be of advantage if the EU would harmonize regulation to a certain extent, not leaving this important issue to the discretion of each individual country.

#### **5.8.4. Winners and Losers of Privatization**

When asked about the outcomes of privatization for the different stakeholders a mixed picture was drawn by the experts. The general attitude was that the ordinary consumers had not benefited from privatization of the gas, electricity and water services. Agreement was unanimous that privatization brought great relief to the public budgets. Furthermore, it was undisputed that shareholders, tax payers and “old” managers (many of whom received golden handshakes) as well as “new” managers (by new opportunities) were winners. However, the opinions diverged regarding the effects of privatization on labour. The majority of the interviewees considered employees to have suffered from privatization. Nevertheless, some experts explained that, in the long run, new employment opportunities were created by privatization, benefiting labour in general (not necessary the same persons who were employed in SOEs). Furthermore, it was explained, that the strong trade unions prevented most of the undue problems for the employees. According to the experts, the “private business sector” in general (and the big industrial families), besides the Finance Ministries, were

considered the main beneficiaries of the privatization process in Italy. Finally, the Local Authorities gained power through participation in financially rewarding privatization activities.

#### **5.8.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Services**

Most of the impact has been described in the previous chapters. The privatized sector has improved as far as efficiency and corporate governance is concerned but this improvement has led to an unbalanced benefit distribution in favour of Government and capital owners (investors). Largely monopolistic structures, “infiltrated by politics”, remained or were established on privatised basis. Like in some other countries the first phase of privatization (mostly non utilities – financial institutions and manufacturing - were concerned) was successful, the later stages led to monopolistic developments, especially in the utilities, and were not considered successful.

#### **5.8.6. Public Opinion towards Privatization**

This situation, described above is reflected in the public opinion, according to the interviewees. But all interviewees answered that on their own view the advantages are more important than the disadvantages. One expert said that privatization created a big positive break in Italy’s culture recognizing that business is basically a private and not public responsibility. At present the public is “tired” of privatization and not interested in it any longer.

#### **5.8.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

Monopolistic structures in the private utility sector, no capacities of regulatory bodies to enforce liberalization, lack of public control due to the fact that media are owned by “should be controllers” and biased benefits in favour of Government and capital owners/large investors are the main negative attributes towards privatization in Italy.

Privatization as a concept is highly appreciated by the interviewees but measures to improve the situation in Italy are difficult to be recommended. Negative structures are deeply entrenched and very hard to change. A stronger impact of the EU on regulation

(harmonization and enforcement) was strongly suggested by a majority of the interviewed specialists.

## **5.9. Valuation of Privatization Issues in Greece**

In three interview events 4 partners took part, two from a consumer organization, one from a government institution involved in privatization and one from an independent think tank.

### **5.9.1. The Current State of Privatization**

Until 1973 the public sector in the Greek economy was relatively small. However, after the military dictatorship fell and the democratic Republic was restored in 1974 the new government embarked on a decisive policy of involvement of the state in the main economic sectors. Triggered by the oil crises of the 1970s Greece's economy went into recession. As a result key sectors of the economy faced financial distress. The government of Karamanli fought the crises through the nationalization of many important Companies including Olympic Airways, Aspropyrgos Refineries, and the Commercial Bank of Greece. A second wave of nationalizations swept the country in the period between 1981 and 1985 under the first socialist government of the Panhellenic Socialist Movement which led to the creation of the Organization for Reconstruction of Enterprises (IRO) in 1983. The goal of the IRO was the restructuring of the highly indebted firms by nationalization, and the creation new firms in dynamic sectors of the economy, as well as further involvement of the state in other industrial sectors. The IRO nationalized firms in important industrial sectors including manufacturing and ship construction. In 1986 the SOE sector's value added was worth more than 17 percent of GDP.

However, from 1985 on the public enterprise sector started to become a financial burden for the state as many SOEs were infect loss makers. The public finance situation became very serious what finally led to a change in Government. The conservative New Democracy Party won the elections of 1990. The new Government considered privatization as the main policy objective, and issued a list of firms to be privatized. The initial stage of the Greek

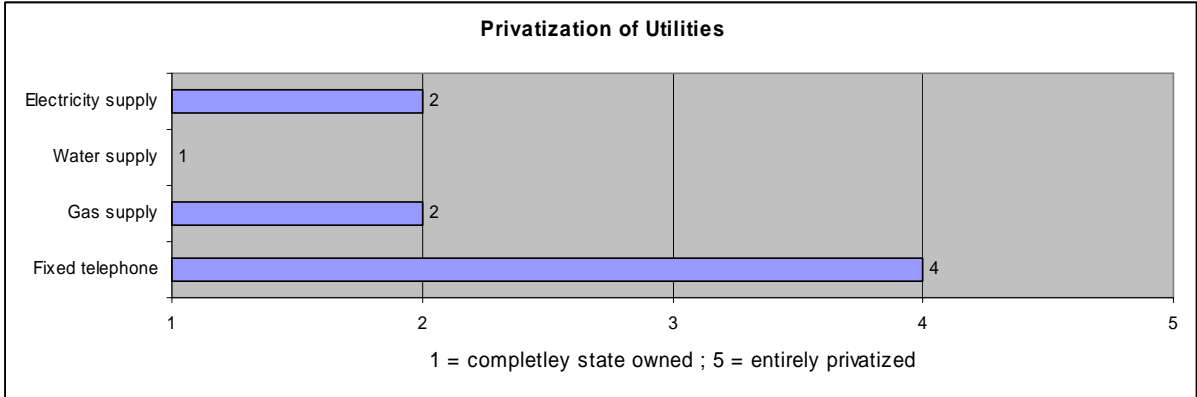
privatization program mainly involved the enterprises belonging to the IRO. The Greek Government adopted a statist, impositional strategy in implementing privatization not basing policies on consent solutions but on state control (taking models from France and Britain). It established an Interministerial Privatization Committee (IPC) comprising the Ministers of National Economy, Finance and Industry. A new framework law was devised in 1991 which empowered the IPC with full executive power. Quick privatization results was the core objective. Careful preparations were neglected (e.g. not a policy of first restructuring companies and then selling them was followed). The first transactions date back to 1991 and 1992 with the full sales of the Olympic Marine shipping company, the Bank of Chios, and of Elvim (Heracles Gen Cement). However, the implementation of this first wave of privatizations showed extreme weaknesses. There was not only strong opposition from the opposition (PASOK) and the trade unions, the statist orientation combined with interministerial-administrative inability to carry out the tasks led by and large to a failure of the first privatization programme and again created a fall of Government in 1993. Socialist Pasok under Papandreou took over and continues very reluctantly privatization programmes. Only once re-elected in 1996 and after Greece was admitted to candidacy in the EU Monetary Union it accelerated privatization again.

From 1996 onwards the utilities sector was included and a main focus of privatization policies.

The privatization process continues until at present with major sales of Government shares in the Banking sector, Telecom and the Postal Savings Bank.

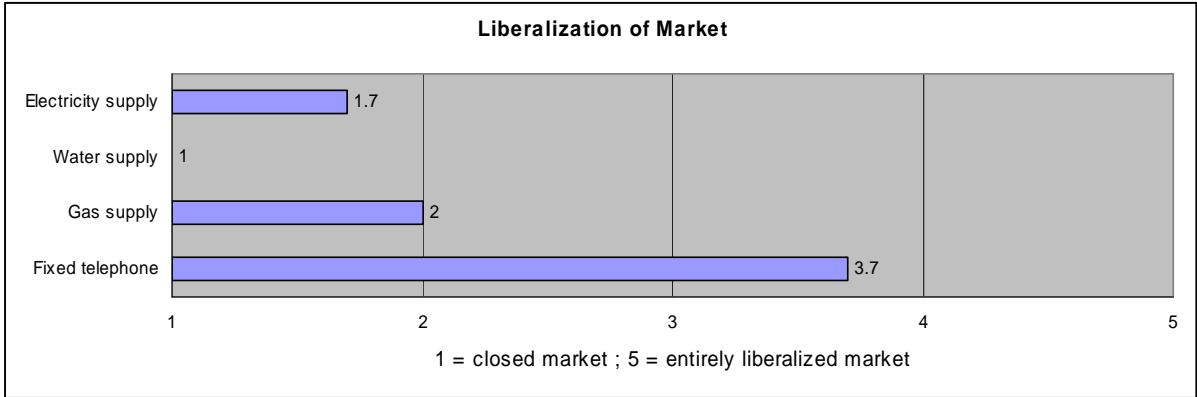
Although privatization revenue targets were achieved, the privatization process in Greece is widely judged to be very problematic. It has the reputation of being a centre for corruption, nepotism, political interventions. It is characterized by largely monopolistic structures with dominant private - public/administrative – political (illegitimate) networks for business decision making, management appointments and investment policies.

Graph 22: Current state of privatization according to Greek experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 23: Current state of liberalization according to Greek experts/stakeholders



Source: Ifo interviews on privatization 2007/8

**5.9.2. Present Driving and Retarding Forces**

According to the four interviewees fixed telephone (and telecom in general) have been privatized and liberalized to a much greater extent than gas, water and electricity supply. In gas supplies some more recent privatization activities have been taken place.

The question of who is driving and who retarding in Greece is somehow difficult to be answered because, as some explain, e.g. consumers may object a bad privatization and support one which may lead to better services and lower prices. Since in Greece consumers in the utilities sector have not gained, in many cases even lost, they are no driving force. The

labour oriented political organizations have objected strongly privatization in earlier times but not so at present. The political left has realized that even by privatization vested interests can be secured. Government and the ruling political parties were very successful in securing control of privatized utilities. They control the appointments of managers and they decide about domestic or foreign investors to a large extent.

A driving force definitely was the EU during the accession preparation, fiscal interests and to a limited extent the private interest groups from the business section (Federation of Greek Industries).

Retarding forces are very much, what was summarised as vested interests of the public sector (employees, managers, Unions, a section of Government) and even a large portion of consumers object to further privatization due to bad experience.

At present, there was agreement among those interviewed, retarding forces come from a wide spectrum of interests and reservations. Driving forces may be very limited and centre around fiscal interests and new investment opportunities for certain investor groups expecting “privileged” access to national assets due to political connections. Since the privatized or partly privatized sectors to a large extent show monopolistic structures, profits of privatized firms can be very attractive for investors.

One interviewed expert pointed at the fact that Greece has a long culture of industrial protection and this may be reason too for the reduced commitment to thoroughly liberalize markets.

However, despite many negative comments as regards liberalization, it was also stated that privatization in the non utilities industrial sector was rather successful in terms of generating more competition, relieving public budgets from financial burden and making enterprises more dynamic.

But present privatization as well as liberalization is hampered seriously by vested interests of the public sector.

### **5.9.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

Like in a number of other EU countries liberalized and rather satisfying competitive structures have been achieved by privatization as mentioned already in the non-utilities sectors. In Greece all four utility areas are judged to have deficits as regards competition – somewhat less in telecom but more in water, gas and electricity supply.

Many examples were reported whereby monopolistic structures were misused to reduce services or increase prices or avoid investments with a potential to reduce the easiness of Government interventions.

In Greece it was reported there is no articulated policy towards types of investors. Personally the interviewed expressed preference towards institutional long term oriented investors from EU countries but they said also that in Greece generally is no reservation against capital from Arabic countries or American pension funds. Here Greece is very liberal. One expert explained that in case of utilities the present Government is not interested in strategic investors at all.

The interviewees generally agreed that networks should be separated from operations. But like in other countries some kept a cautious view. Separation it was stated does not mean privatization necessarily. Physical nets in certain cases better may be kept under public control. And like in other countries bad examples of straight forward privatization from Great Britain were quoted.

Regulatory Authorities do exist in Greece. They have been established rather recently (all before less than 8 years), but they are being judged not to be independent and strong. One reason, it has been said, is the fact that Presidents of the Authorities including of the more important Competition Committee are Government appointees and therefore not independent. A high politicization can be observed as regards regulatory activities. Two experts complained that representation of societal interest groups in regulation decision making is completely absent and in addition, transparency about regulatory decisions does not exist.

The importance of regulation in the utilities sector was not questioned by anybody. But strong (empowered by law) independent bodies would be required claimed the experts unanimously. Two interview parties said that by a stronger EU harmonization of regulations and some pressure from Brussels things could be improved.

In summing up, the regulation of privatised firms in the utilities sector was considered very necessary but the actual situation as regards regulation judged to be very unsatisfactory.

#### **5.9.4. Winners and Losers of Privatization**

In Greece like in most other countries the Privatization produced similar winners and losers. But since public employment is very highly esteemed in Greece, more than in most other countries, privatization was felt by the employees of former incumbents to be very harmful. Social status, employment protection and other privileges common in public sectors were

considered to be reduced or lost. An other Greece-specific attribute of privatization is the very negative judgement by consumer interest organizations indicating that an important part of consumers had serious complaints about privatization effects. Two interviewees pointed out that privatization created monopolistic or semi monopolistic structures which were extremely detrimental for Small Scale Enterprises. Many had to close down and much employment was lost in certain sectors and regions.

### **5.9.5 Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Services**

One of the major problems of privatization in Greece is the lack of factual liberalization. One expert called liberalization in Greece “fake” liberalization. Generally the interviewed did not support that enterprise competitiveness in Greece has been strengthened much by privatization in the utilities. For telecom competitiveness could be increased although consumer organizations complain about bad services. The network infrastructure should be separated from the service operations, this was agreed upon. But a warning was given to separate with great care.

The majority regretted that efficiency, corporate governance and service performance did not improve much in the utilities sector by privatization. A good number of cases were named where these expected attributes of privatization even deteriorated.

Privatization in the utilities surprisingly in the view of the experts had little or no price reducing effect. Even in the telecom sector very little price reduction was perceived after privatization.

Of course, like in other countries the interviewees saw for the utility sector also a public good function. No one opted for unregulated liberalization. But the way how privatization in Greece is handled, some said, misuses the public good function as an excuse for political and private/personal interest manipulation.

### **5.9.6. Public Opinion towards Privatization**

As the interviewees see and interpret the public opinion, there is a widespread uneasiness felt about privatization. Major concerns are in rank order: employment issues, economic efficiency, public finance and consumer welfare. It was explained, although consumers were

hit by negative effects most hardly, they often are not aware of the direct relation to privatization. Even most media are more interested in scandal stories but not in enlightening the public about causes and effects on a scientific or just rational base.

The final question whether privatization in toto in Greece was judged to be more of a success or more of a failure was answered by two to be more of a failure and by two to be more of a success. The two more positive judgements came from Government based experts, the two more negative ones from consumer representatives.

### **5.9.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

The general valuation of the privatization process in Greece showed a range from negative to slightly positive. Among the countries analysed this judgement was among the worst.

The reason is seen by the asked experts in “mismanaged” privatization, deep political entrenchment, and very much in the monopolistic structures of privatized sectors (relating to utilities).

They outspokenly demand more EU interventions, especially harmonization of regulations within the EU, a retreat of Government and politics from the privatized formerly SOEs and a change of awareness on the people’s side who should function as conscious voters and controllers of public affairs as well as more conscious purchasers of media products.

## ***5.10. Valuation of Privatization Issues in Hungary***

### **5.10.1. The Current State of Privatization**

In the case of Hungary four expert interviews were conducted. The interviewees represent the following fields: academia (2), independent think tank and public privatization agency.

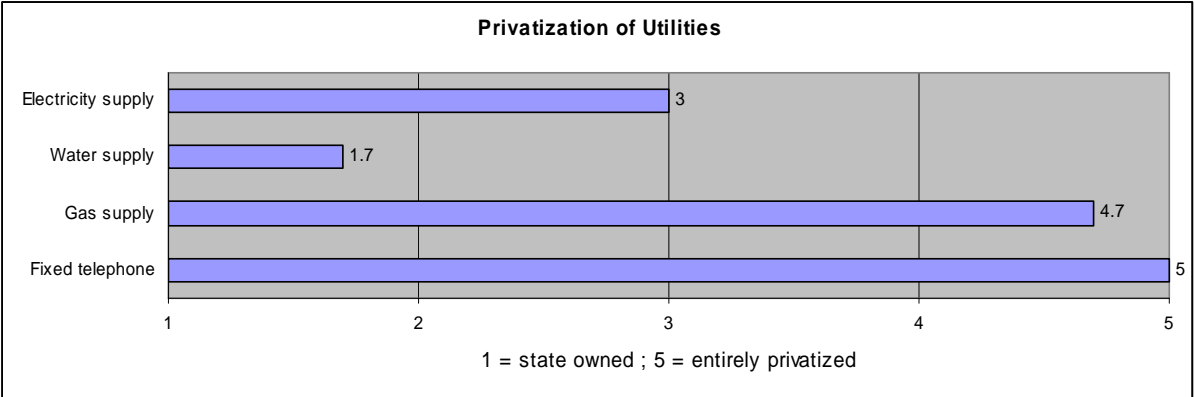
After the Second World War Hungary was occupied by the Red Army which resulted in the birth of the Hungarian People’s Republic. The new regime established a centralized planned

economy which led to a complete nationalization of properties, industry and the financial sector. In the 1970s Hungary adopted a reform of its economic policy which became known as the “New Economic Mechanism”. The newly implemented approach favoured a less centralized approach of managerial decisions, established profit as a primary goal of SOEs and broke with the total planning approach. However, Hungary’s public sector still accounted for more than 85 percent of the Hungarian economy when the socialist system collapsed in the year 1990. As a result of the NEM policy the initial conditions in Hungary regarding the private sector were better than in other east block countries. Nevertheless, the Antall government opted for a centralized approach in the transition of the Hungarian economy towards a market orientated economy. One of the first measures of the Antall government was the establishment of the new State Property Agency, which was responsible for the restructuring and privatization of enterprises in accordance with their managements, and the Hungarian State Holding Company. The privatizations efforts during the first two years (1991-1992) must be characterized as limited. The process gained some dynamic during the years of 1993 and 1994. However, of the total of about 1800 SOEs that had been found eligible for privatization in 1990 little more than a third were privatized between 1990 and 1994. Some of the bigger divestitures of that period include the public offer of 25 percent of the chemical producer Gedeon Vegyeszeti Gyar in 1994 and the sale of 49 percent of Tungsram.

A milestone for the divestiture of SOEs came with the passage of Act XXXIX/1995, the so-called Privatization Act which was implemented by the Horn government as a one of the corrective measures of the so called “delayed shock therapy”. The Privatization Act laid out a new legal framework for divestiture. The process of divestiture thus entered a new, more dynamic, period in the years between 1995 and 1997. Especially the partial divestitures of utilities, previously excluded from the process, marked this new cycle. In 1996 telecommunications giant Magyar Tavkozlesi Rt. (MATAV) was sold to an international consortium formed by Deutsche Telekom and Ameritech International. In terms of revenues the year 1997 marked a record year for Hungarian privatizations as a result of the secondary offering of Richter Gedeon and the IPOs of RABA (mechanical) and MOL Rt. (oil), as well as the sale of Országos Takarékpénztár (credit). Despite the huge revenues generated through the sale of SOEs the privatization process came to a halt , triggered by the unsuccessful privatization of the national airline Malev and the postponement of the sales of controlling shares in chemicals producer Hungaropharma, Antenna Hungaria (telecommunications) and Dunafer (building materials). In fact in 2000 Prime Minister Orbán announced the

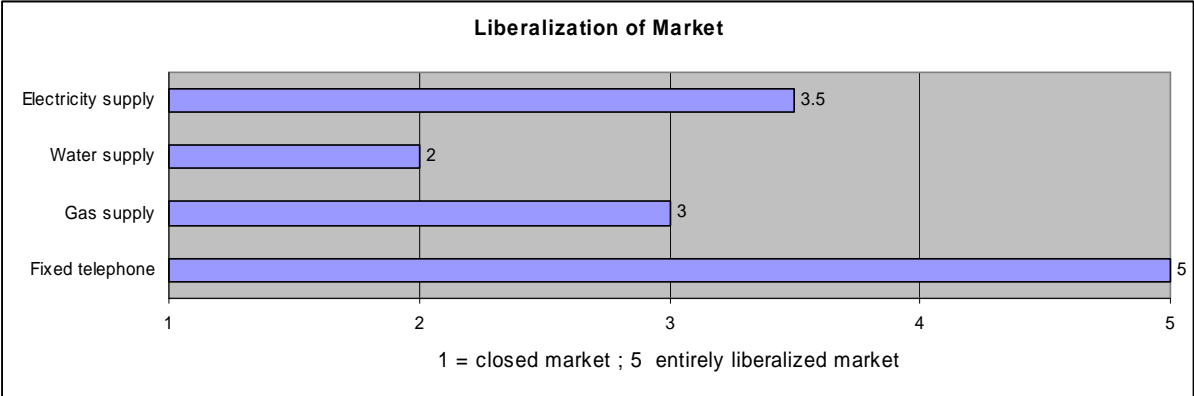
privatization efforts as finished because the public sector had reached the size of other Western European Countries. The elections of April 2002 brought the Medgyessy government into power which was dedicated to continue the divestiture of SOEs based on the conviction greater efficiency of the private sector compared to the state. This marked the beginning of a new wave of privatizations. According to the interviewees, the privatization of the electricity market has not been accompanied by the creation of a competitive market structure. As a consequence the energy sector is currently dominated by local monopolies that dictate the prices. Therefore, a big topic in the current debate is the question whether the liberalization of the retail business in the electricity sector, which is scheduled to begin in 2008 will lead to a drop of prices for energy. According to the experts the privatization and liberalization of the telecommunication sector is largely completed and has delivered reasonable results. The gas market has so far not been liberalized but the current government plans to open the gas market in 2009.

Graph 24: The current state of Privatization according to Hungarian experts/stakeholders



Source: Ifo interviews on privatization 2007/8

Graph 25: Current state of liberalization according to Hungarian experts/stakeholders



Source: Ifo interviews on privatization 2007/8

### **5.10.2. Present Driving and Retarding Forces**

According to one expert the political left has been slowing down privatization efforts over the last few years. However two experts claimed that the political left and the liberals have been a driving force in the process of privatization and liberalization whereas the conservatives and the consumers have blocked any further action. The main arguments that were brought forward by the opponents were based on the security of supply, creation of national champions and the public good character of certain utilities. Furthermore the experts pointed out that it has proven difficult to get support for further privatization and liberalization projects in the general public because of a recent surge in prices (energy). Opponents of liberalization claim that foreign investors benefit from the rising energy prices and transfer the gains out of the country.

### **5.10.3. Liberalization and Competition, Investment Policies and Regulatory Interventions**

The experts pointed out, that liberalization efforts have not led to the creation of competitive markets for utilities. Especially, the gas and the water and electricity markets are not competitive. The gas market has so far not been liberalized but the current government plans to open the gas market in 2009. The experts disagreed when questioned if the state still influences the former incumbents. According to one expert the state still influences the former incumbents. This is accomplished through the appointment of people to the boards of directors, subsidies and the through voting rights. When questioned which kind of investor are suitable as large investors in the former incumbents, one expert named foreign or domestic strategic investors as well as institutional investors to be most suitable. Furthermore according to the experts, major domestic private investors that hold more than 25 percent are seen as critical. Despite liberalization efforts foreign companies still face operational difficulties if they directly want to access clients in the gas, water and electricity sector.

All Hungarian experts were in favour of a separation of network services from network infrastructure. However, one expert explained that in the cases of railways the network should not be separated from the services. Furthermore, the separation of network and services is not advisable in the gas and water sector due to the natural monopoly character of the good. Even in the electricity sector one expert explained that the separation might not be

advisable since it could lead to an overcapacity of network (inefficient). The regulatory authorities are indispensable not only for safeguarding competition but also to ensure that sensitive political issues are taken care of explained one interviewee. However, the regulatory authorities do not work effectively in the water and electricity sector and therefore fail to ensure strong competitive structures.

#### **5.10.4. Winners and Losers of Privatization**

According to one expert the government catered specific interest groups during the privatization process. He explicitly stated that foreign investors have been favoured in the process and should be regarded as beneficiaries. In fact the expert claims that the taxpayers have lost out as the government sold shares of the former incumbents at a low price to foreign investors. Regarding the consumers the experts explained that they feel that privatization has brought a surge of prices. Therefore, consumers regard themselves as losers of the process. However, most experts in fact agree that the prices would have risen even more drastically if the incumbents would not have been privatized. Main beneficiaries of the privatizations have been the managers due to a strong rise of their pay as well as shareholders who have profited from rising stock prices. Employees have often been granted relatively long job guarantees by law. Furthermore, the state subsidises (accounting for 0.5 percent of GDP) the gas sector heavily, as gas is the countries most important and sensible source of energy.

#### **5.10.5. Impact of Privatization on Enterprise Competitiveness, Efficiency and Corporate Governance as well as on Services**

According to the Hungarian interviewees corporate governance and the quality of services have improved throughout all sectors due to the privatization of the former incumbents. In fact one expert stated that the privatization discussion alone has improved service mentality of providers. The prices for goods and services provided by the former incumbents have not decreased, although it is very difficult to disentangle the effects of general price increase from prices decreases due to privatization. Privatization led to efficiency improvements in the telephone and gas sectors. However, the electricity sector and the water supply have not significantly improved their overall efficiency. However since the water sector has not been

liberalized so far Hungary currently faces a market structure that is dominated by local monopolies which set the prices in their respective markets.

#### **5.10.6. Public Opinion towards Privatization**

According to the Hungarian experts the main privatization issues has been the recent surge of energy prices. Therefore, a big topic in the current debate is the question whether the liberalization of the retail business in the electricity sector, which is scheduled to begin in 2008 will lead to a drop of prices for energy. The public seems to be most concerned about an increase in prices and the security of supply. Many question if possible efficiency gains can compensate a possible decline of supply security. Currently the privatization of the water sector is a hot topic in the public discussion (new ownership program) However, one expert explained that water supply is a very sensitive issue and the public seems to be very sceptical about water privatization.

#### **5.10.7. General Valuation of Privatization and Proposals for Improvements by Interviewed Experts**

According to the experts the general valuation of privatization is twofold. Most experts including our interviewees judge privatization to be more or less a success. They indicate that the former incumbents in general perform better, service levels have improved, and prices have risen less than they would have without privatization. However the former incumbents are still not competitive compared to private rivals and the liberalization efforts have not resulted in competitive utility markets. Furthermore the experts expressed the opinion that the regulatory authorities have not succeeded in fostering competition in the gas water and electricity sector. Still despite the ongoing problems experts think that the privatization of the utility sector has led to overall welfare gains. This judgment however is not supported by the general public. Especially the consumers seem to be very sceptical about any further moves towards privatization. This can partly be explained by the fact that consumers blame privatization for the recent surge in energy prices. Regarding future privatization projects the experts stressed the importance of creating competitive markets and capable regulatory mechanisms. Future privatization efforts should mainly focus on the railway, health and education sector explained one expert.

**6. General Conclusions (still to be elaborated)**

**7. Appendices (3 Questionnaires)**