Privatization in the European Union: A Critical Assessment of its Development, Rationale and Consequences

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There is a long history of state ownership of industry in Europe. Since the 1980s, however, privatization has been promoted by economists as the solution to difficulties experienced in managing state-owned enterprises. This study reviews privatization in each of the member states of the European Union. It identifies differences in the levels of privatization activity between countries. It also emphasizes four reasons for the level of interest in privatization within the EU at the present time, with expected economic efficiency gains being but one reason. The study then explains why privatization may not lead to efficiency gains because of the form privatization is taking and the nature of capital markets within the EU. Finally, the study distinguishes between economic efficiency gains and social welfare. Privatization implies a redistribution of income and wealth and therefore of economic power.

Introduction

Europe has a history of state ownership with a major expansion of state ownership of industry occurring in the interwar years and more especially after 1945 (Monsen and Walters, 1983: 1; Anastassopoulos et al., 1987). Until the 1980s, state intervention was generally accepted in Europe, particularly where there was a suggestion of market failure, such as in the network industries (telecommunications, gas, electricity, water and the railways) with their natural monopoly characteristics.

Although major privatization activity in Europe is associated with the UK since 1979, there are examples of earlier sales of state assets, such as in West Germany after 1959, in the UK in the early 1950s

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and early 1970s, Ireland in the 1960s and 1970s and Italy in the 1950s and 1960s. These sales were not, however, part of a systematic programme aimed at slimming down the state sector (with the partial exception of the UK in the early 1950s). This is what marks out the current privatizations in Europe compared to earlier programmes.

This article considers the development of privatization in the European Union. It provides an overview of privatization activity in each of the EU states before turning to consider why privatization is fashionable at the present time. The consequences of privatization are then assessed. There are four main reasons for the privatization activity with expected efficiency gains seemingly not the main driving force in a number of EU states. Even where economic efficiency gains are the main goal, they are not guaranteed because of the forms privatization is taking; while privatization implies a redistribution of income and economic power in Europe which has not been widely discussed and researched.

An Overview of Privatization in the EU

The first major privatizations in the EU occurred in the UK following the election in 1979 of a Conservative government. By 1997 the total value of UK privatization sales had risen to around £65 billion and the share of nationalized industries in GDP had fallen from 9 percent in 1979 to under 2 percent. In the May of 1997 a Labour government was elected for the first time since 1979. During the 1980s and early 1990s the Labour Party strongly opposed the Conservatives' privatization programme. In office, however, the new Labour administration has continued with some minor state asset sales and has agreed the introduction of private capital into the London Underground, though this falls short of actual privatization. Similar 'private finance initiatives' (PFIs) have been announced for other areas of the public sector, such as education and the health service.

Throughout much of the rest of the EU privatization activity was on a much smaller scale in the 1980s. The main exception is France where a right of centre government between November 1986 and January 1988 privatized 14 large industrial, banking and financial trusts (Andreff, 1992: 135). Notable sales included Elf Aquitane in September 1986, Saint Gobain in November 1986, Paribas in

January 1987 and Alcatel-Alsthom in May 1987. Most of the firms affected had been nationalized in the early 1980s, although a few traced their state ownership back to just after the Second World War, such as the bank Societé Générale. This extensive privatization activity was brought to a halt by the re-election of a Socialist administration in 1988.

The 1990s have seen far more privatization activity in Europe. This has been associated with two principal economic pressures, namely liberalization of markets at the EU level and government budgetary difficulties. These two motives are discussed in more detail later. Also relevant has been the election of governments sympathetic to privatization. For example, March 1993 saw the re-election of a right of centre government in France and a renewal of the privatization activity halted by the Socialist administration in 1988. The Privatization Law of 1993 slated 21 enterprises for privatization and since then shares have been sold in a number of French state enterprises, including Elf Aquitane, the insurance group UAP, Renault, Rhone Poulenc, the Banque National de Paris (BNP), Usinor Sacilor and the aluminium business Pechiney. Initially, France chose to concentrate on privatizing industrial and commercial firms operating in competitive markets rather than monopoly public utilities, but in the autumn of 1997 a partial sale of France Télécom occurred. The election of a Socialist government in June of that year only seems to have slowed the pace of privatization. For example, although the new government has rejected the wholesale privatization of Thomson CSF, the electronics group, it has agreed to reduce the state's shareholding from 58 to 43 percent (*Financial Times*, 1998: 34).

Italy began its current privatization programme in 1993 in the face of mounting losses in the state sector. By 1994 the losses of the state-holding corporation the IRI (Istituto per la Ricostruzione Industriale) alone were equivalent to 5 percent of Italy's GDP. In January 1992, after delay arising from political opposition and disagreement between government and the state-holding companies over who should benefit from the privatization revenues, legislation to clear the way for the corporatization, restructuring and sale of state industries was passed. The first important privatization involved 67 percent of the shares in the bank Credito Italiano in 1993 and this sale was followed by the sale of shares in two other large banks, the Istituto Mobiliare Italiano and Banca Commerciale Italiana, and the state-owned insurance group, Istituto

Nazionale della Assicurazioni (INA). By 1996 some 300 state companies had been involved in corporatization and share sales and the total privatization receipts exceeded L18,000 billion. Nevertheless, continuing argument and frequent changes of government have hampered the privatization programme.

Portugal is another 1990s convert to privatization. Until June 1989 the majority sale of state firms was prohibited under the Portuguese constitution and it was not until 1990 that a privatization programme was launched, under a centre-right Social Democrat (PSD) government. Since then the programme has developed quickly and has become more extensive than anywhere else on the continent. To date sales have raised over Es1.3 trillion (over £5 billion), representing about 10 percent of Portugal's GDP and reducing the state's share of the economy from around 20 percent in 1989 to 11 percent by mid-1997. When Portugal recently elected a socialist government, the new government immediately announced that it not only intended to continue the privatization programme but to accelerate it.

In Spain state enterprises were an integral part of industrial policy from the Franco era and were organized around holding companies, similar to those in Italy. By the early 1980s these holding companies accounted for two-thirds of the value added of state industry. Between 1984 and 1986 the government dissolved or sold off over 30 mainly smaller state concerns but including the state automobile firm Seat sold to Volkswagen (Garcia Delgado, 1989: 496) and since then, with continuing losses in a number of state industries and budgetary pressures, further sales have occurred. The years 1989, 1991 and 1997 saw particularly heavy privatization activity. Sales of shares have occurred in SKF Espanola (tyre manufacturer), Endesa (the largest electricity enterprise in Spain), Repsol (formed out of the oil interests of the state-holding company, Instituto Nacional de Hidrocarburos [INH]), Telefónica (telephones), Argentaria (banking group) and holdings in the textile and cellulose industries.

In Finland state-owned enterprises developed as a response to a failure on the part of private investors to invest in the fledgling state, threatened by the Soviet Union to its east. The result was a comparatively large state sector by the 1980s, totalling as much as 20 percent of domestic valued added and 15 percent of the industrial labour force. Since 1987 successive governments have been committed to a privatization programme. In February 1988 there was

a first share issue in the state airline, Finnair, and some share sales occurred around the same time involving the paper machinery, mining and steel sectors. The economic difficulties of the early 1990s halted the programme, however, and indeed a commercial bank was, temporarily, nationalized. Since 1993 the pace of privatization has accelerated again in the face of more buoyant stock market prices. For example, stakes have been sold in Outokumpu, involved in mining and metals, Rautaruukki, the steel producer, and Kemira Oy, a major chemicals group; although only in the case of Outokumpu has the state holding been reduced to under 50 percent.

In 1985 the West German Federal Minister of Finance outlined a general privatization programme affecting 13 firms, but with the government intending to retain a substantial shareholding and in some cases a majority holding. Also, the government ruled out a sale of shares in the loss-making steel, coal and shipbuilding industries and state banks, the railways, posts and telecommunications and research institutes. However, even these limited privatization proposals met with protests from the trade unions and in March 1985 the government reduced the number of firms targeted from 13 to five.

In the following years a cautious privatization programme evolved in Germany (Hawkins, 1991), until the absorption of the former Communist East Germany and the introduction of extensive privatization for that region. Between 1990 and 1994 nine former West German enterprises were sold entirely and three partially, thereby almost ending the Federal government's shareholdings in the industrial sector. However, the *Länder* (regional government) continue to have major shareholdings in public credit institutions, insurance companies, power supplies, transport, construction and property, and some manufacturing firms. The flotation of Deutsche Telekom in late 1996 at a stroke more than doubled the total value of (West) Germany's privatization sales.

Turning to the Netherlands, this country was one of the most laissez faire in Europe after the war in terms of economic policy, resulting in fewer state enterprises than elsewhere in the EU (Parris et al., 1987). Nevertheless, by the 1980s the state participated directly in 41 companies and indirectly in many others, for example through the National Investment Bank and the Industrial Guarantee Fund. The result, according to one observer, was 'a motley collection, each individual holding to be explained by historical

accident rather than by any grand design or strategy' (Andeweg, 1994: 205). A privatization programme was announced in 1982 but the approach has been pragmatic. Shares have been sold in state enterprises whenever it seemed to make economic and administrative sense and when it was profitable to do so. Noteworthy sales have involved the Royal Dutch Airlines (KLM), Koninklijke PTT Nederland, NMB-Postbank Groep (renamed ING Bank), the chemical firm DSM and the state's holding in the aircraft firm Fokker. The total value of privatization sales was inflated by the disposal of Koninklijke PTT Nederlands, the country's largest privatization. In general, the scale of privatization has been limited.[1]

Sweden developed one of the largest welfare states in Europe after 1945, but like the Netherlands saw little need for extensive state ownership of industry. The private sector was viewed as the primary generator of wealth on which large taxes could be levied to pay for welfare services. In the 1970s, however, a number of failing companies were rescued by the state, notably in shipbuilding and steel, and by the mid-1980s the state sector included steel plants, mines, a bank, food and pharmaceutical companies and timber enterprises. In total there were around 70 state-owned joint stock companies and nearly 1400 local government enterprises.

The defeat of the Social Democrats in the September 1991 election led to a major change in policy. In December 1992 a privatization bill was passed by parliament and early in 1992 a privatization commission was set up within the government. The result was a plan to sell 34 state firms, including the electricity company Vattenfall, Nordbanken, Procordia in biomedicine and food products, Celsius in shipping and ASSI and Doman AB in forestry. However, progress in privatizing companies proved slow at first because of a crisis in the Swedish economy and the wider European economic recession. More recent years have seen some build-up of privatization activity, including sales of shares in Procordia, Nordbanken, Stadshypotek AB, AssiDoman and Celsius. In addition, state organizations such as Vattenfall have been turned into joint stock companies and given commercial objectives (Lane, 1994: 183). In total, between 1991 and 1994 the government sold shares in 20 companies, involving assets worth Skr24 billion. However, the re-election of a Social Democrat government in 1994 brought about a reassessment of the privatization programme. The new government agreed to go ahead with the privatization of Nordbanken but shelved the other planned sales.

In the case of Denmark, in the main what state industrial holdings existed have already been sold and the remaining major state-owned firms are in the postal, telecommunications, transportation and energy sectors. In the early 1990s the government began to change the legal status of public enterprises to limited liability companies and more recently has sold shares in some of these companies. The sale of a 51 percent holding in the post office's banking business, GiroBank, in 1993 was the country's first privatization sale. Other sales have involved the state life assurance company, Statsangstalten för Livsförsikring, and the telecom business, Tele Danmark. In 1994 a restructuring of the share capital of Tele Danmark had the effect of reducing the state's holding from 89 percent to 51 percent. The government has also sold 25 percent of its shareholding in Copenhagen airport.

In a number of other EU member states there has been less privatization activity. The economy of Luxembourg is small and the scope for privatization is limited. In Belgium there exists a long-established tradition of mixed-ownership or public and private joint ventures. As a consequence the Belgian government, particularly through the Societé Nationale d'Investissement, owns shares in many companies. Policy towards the sale of these shares has been pragmatic rather than ideological. In large part this results from the federal structure in Belgium and the existence of two linguistic communities. This in turn results in complex, unstable coalition governments and an emphasis on governing by consensus. In 1992 a new coalition government drew up a programme to sell state assets motivated by budgetary pressures and a government commission was established to review assets for possible sale. One result was the sale of 49.9 percent of the shares in the banking and insurance company ASLK-CGER in 1994, another was the sale of shares in NIM-SNI, an industrial holding company. The government has also been looking for foreign telecom partners to invest in the state telephone company. However, the approach to privatization in Belgium has been cautious and there have been no mass state asset sales comparable to those in the UK, France and Portugal, for example.

The same is true of Ireland. Here the government has undertaken only modest privatizations, including sales of shares in state-owned insurance firms and in sugar production (Barrett, 1998). State ownership played a key role in economic policy from the 1920s and

although by the 1980s financial losses in state industries produced pressure for a transfer of some industrial and commercial assets to the private sector, this has not developed into a major programme of privatization. Irish policy remains pragmatic with still some leaning towards continued state ownership. Similarly, privatization remains at a low level in Greece, in this case reflecting political differences over continued state ownership. The election defeat of a right-wing government in 1993 led to the scrapping of earlier privatization plans, including a 35 percent stake in OTE, the state telecommunications company. However, within a year the new socialist government shelved its ideological objections to privatization and decided to float minority stakes in some state-controlled companies and small privatizations occurred, such as the sale of Neorian shipyards by the state-owned development bank, ETVA, to a consortium of Greek shipowners and other business interests. Notwithstanding these sales, political disagreements, union opposition, a statutory limit on equity sales and constraints on the pricing of share issues imposed by the conservative political opposition have all combined to block a number of further privatizations, including the sale of 25 percent of OTE in November 1994.

In the postwar period, Austria had one of the largest state sectors in the EU and the largest on some counts. This dated back to 1946 when industry and commerce seized from the Nazis were nationalized. In 1987, of the nine largest enterprises in Austria, five were totally state owned, one was under majority state ownership and two others were state controlled through large nationalized banks. Only one was privately owned. Following a financial crisis in Voest-Alpine (the steel and engineering group) in November 1985, exacerbated by losses incurred speculating in the oil market, and difficulties in the major state-holding company, ÖIAG, the government announced that it would introduce private funding into some of the state-owned companies. Progress occurred with the ÖIAG's holdings in Siemens Austria and the OMV significantly reduced and minority sales of shares in the Landerbank, Creditanstalt and Austrian Airlines. The state also reduced its holdings in certain other companies. However, adverse economic conditions and a subdued stock market in the early 1990s led to a postponement of further privatizations.

In November 1993 the coalition government parties agreed to renewed privatization and in the following months the state-holding company, Austrian Industries, was merged with the ÖIAG, which

TABLE 1
Privatization Receipts in Selected EU Countries, 1985–95

	US$ billions
Austria	3.0
Denmark	3.6
Finland	1.9
France	34.1
(West) Germany	2.8
Italy	17.0
Netherlands	9.3
Portugal	5.3
Spain	8.3
Sweden	8.0
UK	96.7

Notes: the figures exclude Ireland, Greece, Belgium and Luxembourg where the privatization programmes have been very small. UK figures are from 1977.

became responsible for selling assets. Also, plans were announced to privatize all of Austria's state industries by the end of the decade. Nevertheless, so far sales have amounted to only around 1 percent of GDP. The speed of sale has been slowed by a desire to protect 'Austrian interests': for example, the privatization of the state bank, Creditanstalt, dragged on for over five years, as the government tried to put together a consortium of predominantly Austrian buyers.

It is clear from the above review of privatization activity in the EU that enthusiasm for privatization and the economic significance of privatization have varied considerably from country to country since the 1980s. This is borne out by the figures in Table 1. Table 1 provides estimates of the amounts raised by privatization in a number of the EU member states between 1985 and 1995, the latest date for which reasonably complete figures existed at the time of writing.

Arguments for Privatization

To assess privatization in the EU properly and the forms it is taking, it is important to understand its rationale. Across the EU four arguments dominate: (1) that state industries are inefficient and that

privatization will lead to improved economic efficiency; (2) that privatizations can make a useful contribution to developing domestic capital markets; (3) that selling state assets is a legitimate way of reducing government debt and it removes the risk of future public capital injections into loss-making enterprises; and (4) that privatization is a necessary response to measures within the EU aimed at liberalizing markets. In general, it seems that privatization policies in much of the EU have been more pragmatic and less ideologically based than in the UK and, at times since the mid-1980s, in France.

Promoting Efficiency

The usual argument for privatization over state ownership in the economics literature centres on the comparative economic efficiency of the public and private sectors (for a recent statement, see Boycko et al., 1996). In general, inefficiency is traced back to the ideological and political motives for government ownership of firms and continuing political involvement in their management (Aharoni, 1986; Shapiro and Willig, 1990). Enhanced management accountability in the private sector results from a combination of the transfer from public to private sector funding and the introduction of competitive product markets following privatization (Vickers and Yarrow, 1988; Jensen, 1989; Zeckhauser and Horn, 1989). Insofar as state provision is associated with monopoly provision, the expectation is that privatization, combined with opening up markets to competition (liberalization), will lead to higher operating efficiency.

In the UK the supposed superior efficiency of private ownership was a main driving force of privatization policy for the Conservative governments of 1979 to 1997. But for some governments this has not been so, particularly where state enterprises are considered to have performed well. For example, in Finland, where state enterprises were initially set up to offset a lack of interest by private investors in industrial investment: 'Efficiency has not been an issue, because the state-owned companies' commercial peformance was in general the same as in private firms' (Willner, 1994: 2). The same is to some extent true in the Netherlands, where the management of state firms have been expected to run them efficiently, as if they were private companies. In (West) Germany public enterprises have generally operated commercially with private business interests represented on their supervisory boards. Even where efficiency is an important

issue, the post-privatization structure of industry has often been poorly articulated; for example, in the case of Austria it has been argued that

> Privatization began . . . as a political programme, designed to take advantage of the electorate's increasing dissatisfaction with the nationalized industries. In the 1986 elections both parties referred to privatization as a way of increasing their electoral fortunes, but neither had developed a clear idea of what role privatization would realistically play in future economic strategy. (Meth-Cohn and Muller, 1994: 175–6)

Although in recent years French governments may have argued that privatization promotes economic efficiency, this view is not necessarily widely held in France:

> . . . *the case of France demonstrates that the status of a firm (private/public) is not the only or even the most powerful factor determining its behaviour*. The dynamic of the environment plays a fundamental role. (Redor, 1992: 163; emphasis in the original)

Certainly there are plenty of examples of political intervention leading to loss-making activities in state industries in Europe. However, the exact extent to which these interventions have been social welfare reducing as against profit reducing is less certain. For example, from time to time in the UK and France state industries have been used to control prices and to preserve jobs, both of which are generally incompatible with maximizing short-term profit but can be compatible with a social welfare goal. Employment preservation and good working conditions have also been objectives in other EU economies, notably Sweden, Austria and Ireland. In Finland and Italy state firms have made an important contribution to regional policy; while particularly in Sweden, Finland and France state ownership has been associated with industrial policies to build and preserve international competitiveness. In Finland state industries were supposed to forgo profits and supply private firms with cheap supplies (Willner, 1998). By contrast, in Germany in the 1960s Social Democrats expected state firms to compete aggressively with private enterprises to raise the general level of operating efficiency in oligopolistic markets.

In other words, the usual economists' case for privatization – higher economic efficiency – is not necessarily the chief motivation in all member states of the EU; while any resulting efficiency gains may occur at the cost of reducing the ability of governments

to intervene in the economy to promote economic growth, preserve employment and pursue other welfare enhancing goals.

Promoting the Capital Market

The UK has a large and well-developed capital market and to a lesser degree so have countries such as France and Germany. But this is not so across the whole of the EU. Hence, there is a desire on the part of governments and business interests to promote the national capital market, particularly in Spain, Portugal and Austria and to a slightly lesser extent in Italy. In these countries, privatization flotations are seen as a way of increasing the stock market capitalization and providing a means of encouraging investment and international activity by domestic banks. Privatization is also viewed as a useful vehicle to attract small investors to own shares, as against the fixed interest securities (bonds) traditionally preferred by investors on the continent. In the UK, Conservative governments in the 1980s made a point of emphasizing the role of privatization in spreading share ownership more widely.

The extent to which the new small shareholders are investing long term or for short-term speculative gains is, however, unclear. Of the 2 million Germans who bought Deutsche Telekom shares in 1996, about one-half had sold their shares within one year. A similar pattern of 'stagging' gains has been recorded in UK privatizations.

Reducing Government Debt

Government financing through asset sales has become more important as the prospect of monetary union in Europe has loomed. Indeed, meeting the Maastricht criteria for eligibility to join a single currency has become a very important consideration driving privatizations in a number of EU countries.[2] Although the European Commission has ruled that privatization receipts cannot be taken into account when calculating budget deficits under the Maastricht criteria, privatization receipts can be used to reduce the public debt – another of the treaty criteria – and a lower debt reduces interest payments made by government and therefore, indirectly, the budget deficit. Privatization receipts are seen as a

less politically painful way of reducing state debt than either spending cuts or tax increases.

Indeed, so close has the link between privatization and the public finances become in member states that governments have announced targets for annual sales as part of their budget forecasts. Moreover, in Austria privatization share issues were not priced low (as occurred in the UK, especially in the 1980s) specifically because the government wanted to raise the maximum revenue possible for the budget and industry restructuring. In France and Italy legislation has been passed to limit the use to which privatization receipts can be put. Under French legislation of 1986, privatization proceeds had to go into repaying public debt or recapitalizing the remaining state enterprises. This was amended in 1993, since when receipts have been paid into the general budget. In Italy a law of October 1993 required that revenues from privatization be set aside in a special fund to be used for the sole purpose of buying back outstanding public debt. In Portugal revenue generation was a prime objective behind the privatization programme from 1990. Until July 1993 80 percent of privatization funds were to be used for state debt reduction (*Privatisation Yearbooks*, various editions). In Spain privatization proceeds now go through a new state-holding company, Sepi, and are used to offset the costs of running loss-making shipyards, arms factories and mines and meeting redundancy costs in the state steel industry. These are costs that would otherwise have fallen within the government's budget.

EU Liberalization Directives

Traditionally, EU policy has been neutral on the ownership of industry, accepting the existing mix of state and private sector industry across Europe. This approach arose from the need to accommodate within the EU from the time of the Treaty of Rome countries with differing levels of state ownership. It also arose from the belief that state monopolies were necessary in the public utility sectors to ensure a universal service and network economies. In post-war Europe postal services, telecomunications, railways, scheduled air and bus transport, electricity and gas industries and water and sewerage services were typically owned by central government or local municipal or regional bodies; although there were some important exceptions, such as water supply in France.[3]

Throughout the Treaty of Rome runs the principle of free trade. Articles 30–37 set out the aim of free circulation of goods, while Articles 52–66 are concerned with the freedom to provide services and the freedom of establishment. Article 37 states that:

> Member states shall progressively adjust any State monopolies of a commercial character so as to ensure that when the transitional period has ended no discrimination regarding the conditions under which goods are procured and marketed exists between nationals or Member states.

Article 222 confirms neutrality on ownership by stating that the commitment to a market economy 'shall in no way prejudice the rules in Member states governing the system of property ownership'.

In other words, competitive markets are favoured but this is not taken to prejudge the form of ownership that should be adopted in member states. EU policy intervenes only when government policies are seen to be in conflict with free and fair trade within the EU. In particular, Article 92 forbids state aid that distorts competition between member countries; although in practice derogations have been granted under Commission guidelines that allow for the influence of other policy objectives, such as regional development, protection of the environment, industrial policy and R&D. At Maastricht in 1991 Article 130 was inserted into the Treaty confirming that industrial policy measures must comply 'with a system of open and competitive markets'.

Until the 1980s the Commission stressed coordination and network economies when discussing the public utilities and to a degree still continues to do so, in part 'to reduce tensions between the Member states and the Community institutions' (Scott, 1995: 35). The attitudes of member states now vary considerably on the proper role of the state in the ownership and control of the utilities with some members, notably France, more cautious about privatization than, most obviously, the UK, where all the utilities have been privatized. Nevertheless, an interest in market liberalization exists in all parts of the EU.

Particularly significant in changing attitudes was the passage of the Single European Act in 1986. This aimed to remove the remaining non-tariff barriers to free trade within the EU by the end of 1992 and had implications for the public utilities, which were generally protected from competition both in terms of outputs and procurement policies. Utilities remain governed by national legislation and regulatory rules, but following the Single Market Agreement,

the European Commission has applied pressure on member states for utility markets to be opened up to competition.

European Union-level intervention in utility markets was and remains, however, controversial. Member states are reluctant to see national sovereignty over their public utilities transferred to Brussels. In response the European Commission has fought shy of proposing EU-wide regulation. Instead, the Commission has endeavoured to convince member states of the case for opening up their utility markets to competition and of the need to develop their own, national regulatory systems to promote competition and protect the consumer. To minimize opposition and to ensure a more speedy liberalization, the Commission has adopted a 'vertical' or sectoral approach to policy-making rather than attempting to force through a 'horizontal' or across the board programme. This has meant developing separate market-liberalization policies for each utility sector.

Each policy has progressed at different speeds reflecting practical opportunities for liberalization in the member states and the strength of national opposition. For example, the Commission has suggested that rail links between member states should be opened up to competition and that operators should pay for track use (Hitiris, 1994: 273). Under a 1991 EU directive railways should separate infrastructure charges from operating costs for book-keeping purposes and this has already occurred in some member states, notably the UK, Sweden and France. Separate accounting is a step towards enabling new train operating companies to provide services on the rail network. This liberalization has met, however, with fierce resistance from the railway unions, especially in France. In addition, governments are suspicious of the impact on railway finances and the viability of their current rail networks. In 1995 the Commission proposed opening up rail freight to cross-border competition, but following a serious rail strike in France the proposals were scaled back to cover only the busiest freight routes.

There has been similar slow progress in the liberalization of the gas market and postal services: but there has been progress in deregulating European air routes, with effect from April 1997, the electricity power market and telecommunications. In response, a number of governments have sold some or all of their stakes in national airlines and power and telecommunications companies (for full details see Parker, 1998). Although at the EU level no explicit stance has

been taken on ownership, from time to time there has been recognition that privatization may be beneficial where markets are liberalized. For example, in 1994 the Commission stated that 'attention should be devoted to improving the competitive environment in which firms operated' and that 'privatization, to the extent that Member states judge it compatible with their objectives, could further the progress already made in this direction.' (European Commission, 1994: 11). In a 1995 White Paper the Commission repeated the point:

> . . . progress is required . . . in the areas of insurance, intellectual and industrial property, public procurement, new technologies and services and freedom of movement. Moreover, progress has been slow in the extension of the single market to telecommunications and energy, while the internal market in transport remains incomplete. Furthermore, additional progress is necessary in reinforcing competition rules, reducing State aid and reducing the role of the public sector. Privatization, to the extent that Member states judge it compatible with their objectives, could further the progress already made in this direction. (European Commission, 1995: 15)

Summary of the Arguments

In summary, across the EU there is no single, common rationale for privatization. Some countries are promoting privatization to achieve efficiency gains; but at least as important in other member states is the potential of privatization sales to expand the capital market and meet the Maastricht criteria for monetary union. Some governments are seemingly pursuing all of these objectives, even though they may not be compatible. For example, to achieve efficiency gains an industry may benefit from restructuring ahead of sale to promote competition, but by removing the opportunity for monopoly profits sale receipts are reduced and therefore so is the contribution to the state budget. Promoting a domestic capital market may mean restricting foreign shareholdings, but foreign investors may help promote a more effective capital market constraint on managerial behaviour, as discussed later.

As the EU has worked towards removing restraints on trade resulting from regulation, this has had implications for the nature of ownership in industries previously protected from competition. Deregulation policy implies a change in the relationship between government and state-owned utilities, most notably in terms of

ruling out state subsidies and introducing private sector competition. In turn, this creates a policy environment which leads member states to review the benefits of retaining state ownership. State-owned firms may be handicapped when facing competition from large private sector companies with ready access to capital markets. At the very least, competition can be expected to worsen the finances of the incumbent state-owned utilities, perhaps necessitating large capital injections. Privatization is therefore a means by which governments can avoid financial risk when markets previously dominated by state-owned companies are liberalized.

Consequences for Economic Efficiency and Social Welfare

Privatization is changing the ownership of major industries and services across the EU. Exploring the consequences is, however, complex. Here two issues are discussed, economic efficiency and social welfare.

Economic Efficiency

Where privatization does lead to higher economic efficiency, this is most likely to occur in the early years after a disposal through cost reductions, for example through reduced staff levels. This leads to what economists call *static* efficiency gains. Static gains involve moving the firm to its production possibility frontier (removing 'waste') and are inherently 'one off'. Longer-term competitiveness depends rather more on improved products and production processes. In other words, it requires a movement outwards in the firm's production possibility frontier, which in turn requires ongoing restructuring, appropriate capital investment, innovation, marketing, human resource policies to improve productivity and improved supply chain management. Whether these *dynamic* gains will result from privatization is, however, particularly unclear at the present time. So far the empirical evidence from the economy with the largest and longest-standing privatization programme, the UK, is mixed. There is evidence of initial cost cutting in privatized companies (static gains) but less evidence of continuing performance improvements (see Martin and Parker, 1997), though it will only be possible to reach a final decision on the results over a much

longer time frame. Industrial policy involving state investment and encouragement to markets to redirect resources, as practised within the EU in the past, particularly by the French, is based on the notion that private markets fail to provide adequate investment, especially in new technologies. Privatization, on the other hand, involves a greater reliance on private markets.

The economic case for privatization is predicated on arguments from the public choice, property rights and agency literatures in economics (e.g. Niskanen, 1971; Mitchell, 1988; Shapiro and Willig, 1990; Boycko et al., 1996). This literature needs to be viewed carefully, however. In particular, the notion that the private capital is a more effective monitor of management discretionary behaviour than state control needs to be demonstrated. It is usually argued that shareholder pressure, trading in shares and ultimately the threat of a hostile takeover bid reduce managerial non-profit behaviour in the private sector, leading to higher economic efficiency. But, where privatizations are associated with dispersed shareholdings it is not clear that any shareholding group will be able to bring sufficient influence to bear on management to ensure that companies are efficiently run; while the corporate governance debate in the UK has raised questions about the lack of involvement of even larger institutional investors in the management of firms (Stapledon, 1996). Also, the takeover market is expensive and disruptive and there is little evidence that it is necessarily the poorly performing firms, in terms either of earnings, dividends or share price, that are the prime takeover targets in modern stock markets, or that improvements in performance necessarily result (Jenkinson and Mayer, 1994; Mayer, 1997: 294). Cosh and Hughes (1995) have concluded that ‘acquisition has an insignificant impact on profitability’. Moreover, empirical studies of the comparative efficiency of public versus private sector firms (usually measured either in terms of productivity or costs of production) suggest that, while private enterprises are sometimes more efficient than their state-owned counterparts, state enterprises can be as efficient, especially in markets where there is little or no product competition (for an early summary of this research, see Millward and Parker, 1983).

The economics literature emphasizes the role of a competitive capital market in raising economic efficiency, but with respect to privatizations in a number of member states a competitive capital market is not the inevitable result. In continental Europe the term ‘equity’ in financial markets implies a right to the residual income

and assets of a company, subject to a much wider stakeholder (e.g. workforce) influence than in the UK. Also, the stock markets in countries such as Germany are less open to the mounting of hostile takeover bids than is the case in the UK and the USA, from which much of the economics literature on agent–principal relationships originates. In other words, the so-called 'outsider' model of corporate governance, relevant to the UK and USA with arm's length shareholders and active stock markets, and on which the notion of the takeover as a discipline on management behaviour is based, may not be relevant (Albert, 1993). On the continent an 'insider' model is more common, in which shareholders sit on boards and have a longer-term relationship with the firm; notwithstanding that this model is being challenged by larger and more competitive capital markets, for example in Germany. Where the insider model continues, action to change management decisions occurs through internal channels, such as participation on boards and committees, and not through share trading and takeovers. This form of corporate governance is much closer to that found under state ownership, which also involves a long-term investor and influence on management through internal, 'political' channels, in which case, while the objectives of the 'stakeholders' may differ between the private and public sectors, the mechanism of corporate governance may not be very different.

The precise form of privatization is also likely to affect the outcome. It is important to appreciate that acceptance of privatization on the continent has not necessarily entailed acceptance of the case for a more open market in corporate control, as exists in the UK and USA. In a number of member states there are examples of privatization policies which are designed to favour 'reliable' investors and restrict speculators. For example, in Belgium sales have been on the basis of a preselection of investors not public offers. In Spain sales of state shareholdings in the 1980s involved mainly the sale of minority stakes because the government did not want to forgo control of the enterprises. The government also feared that the companies might fall into the hands of foreign investors. The sale of Seat to Volkswagen was a notable exception to this rule because there was no domestic motor group available to purchase and rationalize the company.[4] In the case of Portugal, the government has been accused of rigging privatization sales to favour domestic groups that the government had privately considered from the outset to be suitable owners (*Financial Times*, 8 November 1995: 6). The

current government in Portugal has stated more firmly than its predecessor that it intends to keep strategic companies Portuguese. The long delay in Austria in the sale of Creditanstalt was the result of opposition in Austrian business circles to the country's second biggest bank falling into foreign hands (Hall, 1996). In Sweden the government has favoured large and friendly investors. But it is in France and Italy that a traditional hostility to foreign ownership of industry has developed into the most prominent policies to retain national ownership.

Some foreign investor participation in recent French privatizations has been permitted, but in general policy has discriminated against foreign capital. Legislation of August 1986 prevented the state transferring more than a 20 percent stake in privatized firms to foreign investors, though the limit was removed in 1993. However, French policy has continued to favour established, mainly French, core shareholders or *noyaux durs*. The objective of a *noyau dur* or favoured shareholder is to facilitate a smooth privatization and to limit any post-privatization takeover threat. For instance, in the 'first phase' of denationalizations, in 1986–8, the hard core were 12 industrial firms, 12 banks, 11 insurance companies and 10 other corporations in France (Andreff, 1992: 148), included were the banks Crédit Lyonnais, Societé Générale and BNP and the insurance business AGF. Since 1993 the core shareholders in France have been widened to include some foreigners, notably the Italian company FIAT and the bank Crédit Suisse, but still on the basis that these shareholders will not sell out quickly for speculative gains. Similarly, Italy has its own *noyau dur* policy, for instance the preferred purchaser of shares in Istituto Mobiliare Italiano were banks owned by the government; while the sale of Credito Italiano was structured around the Milanese merchant bank Mediobanca.[5]

Although this policy conflicts with the notion of a European-wide competitive capital market, it reflects a deep-seated fear among EU governments that privatization will lead to a loss of national control over important industries. Even the UK has placed limits on foreign shareholdings in some privatized companies. A further argument relates to the size of the domestic capital market. The UK has a large and international market, but capital markets are much smaller in many other EU countries, necessitating efforts to attract specific investors to privatization issues.

Improvements in economic performance are less likely the smaller the pressures on management to restructure their organizations

post-privatization. Improvements are also less likely where constraints on restructuring exist. For example, in Italy legal restrictions on job cuts in banking and finance, where early privatizations were concentrated, have meant formidable difficulties in rationalizing staff levels. In the Netherlands, employees made redundant because of privatization have been offered jobs elsewhere in the public sector and workers have retained a right to preferential civil service unemployment benefits (Andeweg, 1994: 204–5). A similar situation exists in Germany, where many railway, telecommunications and postal service employees have civil service status.[6] When a new state-owned telecommunications company replaced the former state enterprise in Italy, all of the employees were guaranteed their jobs. In the Netherlands, incomes of the low paid have been guaranteed by the state during the first years after privatization (Andeweg, 1994: 204–5).

In other words, across Europe privatization does not appear to offer the same scope for early (static) efficiency gains through reduced staffing costs as existed in the UK. Also, the extent to which efficiency improves will depend upon management responses to the new private sector environment. State ownership has been associated with civil service procedures, caution and bureaucracy (Mitchell, 1988). However, the extent to which management behaviour will differ following privatization is unclear. Capital market pressures may not alter much; there may be restrictions on altering working practices; and often the same management remains. Moreover, the social and educational background of public sector and private sector management in big businesses tends to be the same, which may reinforce similar behaviour. For example, in France typically both go to state-financed *grandes écoles*, of which the most famous are the National Schools of Administration (Redor, 1992: 158). Also, managers have moved between public and private firms much more frequently than is the case in the UK. All of these considerations may help to explain why, on the continent, there is often a lower expectation of efficiency gains when enterprises are privatized than has existed in UK policy-making circles.

Finally, it is important to emphasize that 'privatization' is not necessarily associated with the ending of state involvement in industries. In particular, 'corporatization' is not the same as privatization. This needs stressing since a number of countries have transferred state activities from departmental control to quasi-independent corporations and insisted on describing the policy as 'privatization',

even when the state retains majority voting rights. In other cases, restrictions have been placed on the rights of private shareholders. For example, when the Austrian government sold shares in the engineering firm VA Technologie, no shareholder was permitted to exercise more than 25 percent of voting rights at the company's annual general meeting. Elsewhere the state has retained some kind of 'golden share' to block unwelcome takeover bids, including the UK. If the term 'privatization' is to be meaningful it should be limited to those cases where the state agrees to sell all or a majority of its (voting) shares, places no special restrictions on voting rights and share trading, and ceases to interfere in the management of the enterprises. Defined in these terms, privatization has been much less extensive in the EU than the figures for share sales suggest.

Social Welfare

Even where higher economic efficiency results from privatization, it is important to recognize that economic efficiency is only one part of social welfare. In particular, social welfare also requires attention to the *distribution* of income and wealth. To assess the full effects of privatization on social welfare requires a cost–benefit analysis with identification of gainers and losers and measurement of the precise gains and losses. It also requires some form of social weighting of the gains and losses so as to be able to aggregate them.

At this stage economists usually retreat, commenting that income distribution issues are beyond their competence. However, a proper study of the consequences of privatization cannot avoid attention to gainers and losers. To date there have been some studies of the impact of privatization on consumers (in terms of prices and services), shareholders (in terms of profits and share prices) and workers (in terms of wages, conditions of service and unemployment) suggesting income effects (see Martin and Parker [1997] for a review). A number of the studies have viewed lower wages and other input costs as desirable outcomes, as they reduce costs and prices and raise consumer surplus and profit. In particular, higher payments to labour under state ownership are interpreted as 'inefficient' rents.

Arguably, such discussion side-steps the importance of income effects. Across the EU privatization implies a shift in economic power from the state to private capital markets with an associated

redistribution of income – just in the same way as nationalization implied income transfers, though to a different set of interests. More specifically, there is evidence that privatization is leading to a shift in economic power and income to large business groupings. For example, French privatization has directly benefited the *noyaux durs*, made up of large banks and companies.[7] In Italy privatization has strengthened the position of already powerful business groups, such as those connected with the Agnelli and De Benedetti families (Wright, 1994: 33). In general, privatization in the EU has been driven from the top, at government/industry/banker level, very little has occurred due to action from below, in terms of worker/manager-initiated ownership restructuring. McAllister and Studler (1989) claim that the UK's privatization policy was primarily instigated by Conservative governments to favour an 'elite interest'.

The result is that some groups in society are benefiting much more than others. In addition to those business interests that now own shares in privatized concerns, other obvious gainers have been the bankers and financial advisers who have received commissions and fees for arranging the sales, certain politicians who have been rewarded by jobs, and senior management in the privatized companies where, as in the UK, remuneration has rocketed. In the UK there are close ties between the City of London, which has gained from privatization through consultancy and flotation fees, and the Conservative Party, which governed from 1979 to May 1997. A number of government ministers involved in privatization have subsequently obtained highly paid board-level appointments in privatized companies and City firms.

The losers are those interests now less favoured by government, usually the trade unions and those vulnerable to unemployment and wage cuts post-privatization. In particular, those workers most likely to lose are the lower skilled, poorer educated workers who were likely to be more highly unionized under state ownership. New investment along with new manning agreements aimed at boosting profitability are likely to have adverse impacts on this group of workers, and at a time when global economic trends are already removing lower skilled jobs across Europe. An increased interest in 'outsourcing', to reduce headcount and cut costs, has been associated with privatization in the UK (Harris et al., 1998). By contrast, more highly skilled and educated workers are often less vulnerable to post-privatization restructuring including out-

sourcing (for a detailed discussion, see Pendleton and Winterton, 1993; Parker, 1995).

Privatization suggests a more favourable view of the role of private (sometimes multinational) investment in promoting social well-being and a less favourable view of employment, employment rights, wages and trade union collective bargaining than existed for much of the postwar period in Europe. Whereas such 'rights' were once part of a postwar political consensus based around the notion of a 'welfare state', they are now viewed as 'inefficiencies' that threaten European competitiveness. As Shapiro and Willig (1990: 65) note in their study of privatization: 'The key distinction between public and private-sector enterprise . . . is that privatization gives informational autonomy to a party who is not under direct public control.' Nationalization resulted from a belief that state ownership could counter the adverse effects on economic welfare of large-scale private enterprise, much of which today is transnational (Holland, 1975). Privatization is removing this means of state influence in the economy. In this sense it is substituting private markets for earlier social welfare and industrial policy objectives in Europe. Where a penetration of international capital into industries previously controlled by government leads to a transfer of economic power out of EU countries, then a decline in state control over the economy results. This should be of particular concern given that privatization is occurring at a time of other changes, resulting in greater capital mobility and reduced state control over factor and product markets.

A loss of control at the national level implies the need for stronger monitoring and regulatory powers by the EU, but so far the European Commission's powers continue to lag behind the pace of economic change (Begg, 1996). In the European Commission there seems to be no sense of urgency to develop new regulatory powers to counter the threat from private monopoly abuse. This is in spite of recent evidence of growing numbers of takeovers, cross-shareholdings and interfirm alliances among privatized companies in the newly 'liberalized' markets. The proliferation of recent strategic alliances among world airlines and telecommunication companies and the takeover of privatized companies (e.g. UK regional electricity companies mainly by US energy utilities) raise questions about the extent to which the state should intervene and the adequacy of existing regulatory systems in Europe to police competition. What appears to be lacking within the EU is a clear

policy response to the potential transfer of economic power implied by these changes. Where there is no market failure, economics suggests that profit maximization can coincide with welfare maximization. But many enterprises were taken into state ownership precisely because of perceived market failure.

In sum, privatization across the EU raises important questions about 'power' and 'control' – where is economic power centred in terms of individuals, corporations and geographic head offices, and who controls in terms of making strategic decisions for example relating to industrial expansion and contraction? There is a large literature on income distribution, social justice and state/class power on which to draw to assess the impact of privatization in terms of power and control. However, the privatization literature tends to be dominated by concern with economic efficiency. Issues to do with power and control in social welfare either become secondary issues in this literature or are ignored altogether.

Where the state retains a substantial shareholding in enterprises then it might be expected that the social welfare outcomes would be different than in instances where full privatization occurs. But this is not necessarily the case. Much will turn on the size of the state's shareholding and therefore potential influence, the extent to which the state actually intervenes in management decision-making, and the social welfare goals of government. Governments may pursue a vigorous restructuring and staffing agenda. The implication of continuing state shareholdings for an interpretation of 'control' issues in an era of privatization is worthy of detailed research, extending beyond concern for economic efficiency.

Conclusion

This study has reviewed privatization activity in the different member states of the EU and has revealed some marked differences in both the pace and content of privatization programmes. It has also reviewed the reasons for the current interest in privatization. Whereas in the UK and France privatization has been justified in terms of inefficiency in state industries, this has been less true in a number of EU states with more efficient state enterprises or where state firms were created to overcome inefficiencies in private capital markets. Across Europe, privatization is a response to increased market liberalization required by development of the European

Single Market and supporting Commission directives. It is also a response to budget deficits as member states endeavour to meet the Maastricht criteria to join a single currency. In addition, some countries with less developed capital markets have pursued the flotation of state firms to expand trading in their stock markets.

The study has also looked at the consequences of privatization for economic efficiency and social welfare. The economic case for privatization raising economic efficiency relies heavily on a competitive private sector capital market being a superior monitor of management behaviour to the state. However, the use of preferred, long-term investors at the time of privatization coupled with the 'insider' model of corporate governance, still found on the continent though under strain, suggests that efficiency incentives may be blunted. The result may not be the active trading in shares and hostile takeover bids that many economists have argued are essential if enterprises are to be managed efficiently in the private sector. Management in the newly privatized firms may face long-term investors, investors in this respect not very dissimilar to those management faced when state owned.

Turning to social welfare, judging the outcome is complex but it is clear nevertheless that privatization is leading to important changes in income and wealth distribution. As Eisner (1993) has argued, the last 20 years have witnessed the end of the *societal regime* of the 1960s and 1970s, with the goal of raising social conditions in Europe, and the arrival of the *efficiency regime,* involving market liberalization and reducing the state's role. This change, in turn, has implications for the distribution of economic power in Europe. This is so particularly while the EU lacks a policy for effective regulation of the newly privatized markets.

These conclusions should not be viewed as necessarily implying that privatization in the EU is foolhardy. There is evidence that privatization has introduced a new competitive spirit into some sleepy state enterprises – though not all (Martin and Parker, 1997). What the conclusions do suggest is that the subject of privatization in the EU deserves far more critical attention from economists and others than it has so far received, centring on the longer-term effects on the competitiveness of European industry and the implications for social welfare.

Notes

1. In addition to central government asset sales, in common with a number of other countries the municipalities in the Netherlands have developed policies to contract out municipal functions. Space precludes a discussion of the contracting out of government services.

2. The Maastricht criteria for 'sustainable economic convergence' and eligibility to join the European Monetary Union are: (1) an inflation rate in the previous year of 1.5 percent, at most, above the three member states with the lowest inflation; (2) long-term nominal interest rates in the previous year not exceeding by more than 2 percent the average rate in the three member states with the lowest rates; (3) general government net borrowing and nominal gross debt below 3 percent and 60 percent of GDP respectively (known as the *fiscal convergence* requirement); and (4) a stable currency within the narrow band of the European Monetary System without realignments or 'severe tensions' for at least two years.

3. The French water sector is a hybrid of public and private management with about 70 percent of French water supply consumers and 35 percent of sewerage service customers served by private companies under contracts with municipalities (communes) (Burns and Parker, 1997).

4. In the last few years more foreign investment has been permitted because the Spanish domestic capital market has been judged inadequate to absorb all of the privatization issues. Nevertheless, when a further 8.7 percent of shares in Endesa, Spain's biggest electric company, were floated, 53.6 percent of the issue was reserved for Spanish nationals.

5. In Italy the Privatization Law of February 1994 allows for a stable nucleus of shareholders (*nocciolo duro*) in privatization issues. It also includes powers for the government to restrict individual investors' and associated parties' voting rights to no more than 5 percent of a company's shares. 'So far Italy's treasury has sold only two businesses completely – INA, an insurer, and IMI, a financial-services group. But neither was a true privatisation. In both cases, control passed to "core" shareholder groups of public-sector banks' (*The Economist*, 2 November 1996: 102).

6. The German postal union has secured Deutsche Telekom employees' continued status as civil servants after privatization. Employees in France Télécom will continue to have civil service job protection rights.

7. Recently there has been an influx of foreign capital into French shares and some evidence of an unravelling of cross-shareholdings among French companies. Foreign ownership in France's largest industrial company, Elf Aquitane, has now reached almost 50% (*Financial Times*, 1997: 23). Nevertheless, this does not reverse the conclusion for France that large business has been a primary beneficiary of privatization.

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