The Treasury

Mixed Ownership Model for Crown Commercial Entities: Treasury Advice Information Release

4 September 2012

Release Document

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Treasury Report: Privatisation Case Studies

Date:	30 March 2012	**Report No:**	T2012/592

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Bill English)	**Note**	None
Associate Minister of Finance (Hon Steven Joyce)	**Note**	None
Minister for State Owned Enterprises (Hon Tony Ryall)	**Note** and **forward** to your communications staff	None

Contact for Telephone Discussion (if required)

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Minister of Finance's Office Actions (if required)

None.

Enclosure: **Yes (attached)**

Privatisation case studies final DB (Treasury:2307179v1)

Treasury Report: Privatisation Case Studies

Purpose of Report

1. Hon Tony Ryall requested some information on privatisation experiences around the world. Deutsche Bank (DB) has provided the attached paper detailing privatisation experiences for a selection of five countries considered reasonably comparable to New Zealand. DB notes that Canada, Australia and the UK are particularly relevant as a large number of their privatisations were by way of IPO. This report draws out some of the main insights and provides some New Zealand context.

High Level Points

2. Some high level points from DB's paper are as follows.

- Over the last few decades, over 130 countries have privatised at least 75,000 former State owned enterprises. Privatisation programmes have effectively halved worldwide state ownership of assets. Governments have tended to use three sale methods: asset sales, voucher or mass privatisations (primarily used by formerly socialist countries), and share issue privatisations (effectively IPOs). Since 2000 share issue privatisations have become a more prevalent sale method.

- Across the OECD approximately 50% of SOEs are 100% government owned and a further 20% are majority government owned. Ten percent of OECD SOEs are partially listed. Norway and Finland have 20-25% of SOEs partially listed.

- The primary motivations for undertaking privatisations were to improve the governments' fiscal positions, to improve the efficiency and profitability of the companies, and to aid capital market development.

- Assessments in the academic literature on the success of privatisation programmes have tended to become more nuanced over time. Early research during the 1980s and 1990s tended to simply measure the performance of the companies before and after privatisation. Generally these studies were able to demonstrate strong improvements in efficiency and profitability.

- Later research has accepted that much of the improvement in company performance can often be attributed to the corporatisation process whereby the entities were transformed from being government departments, improvements in competition policy, broader economic deregulation, and movements in the economic cycle.

- While causality is difficult to be certain of, countries that have launched large-scale IPOs have experienced rapid growth in national stock market capitalisation and trading volumes.

New Zealand Context

3. To provide some New Zealand context we would like to focus on the economic efficiency[1] discussion within the privatisation debate. We were unsurprised to see the evolving conclusions in the academic literature referred to in DB's report as we had formed similar conclusions when we were working on the original advice on the Government's MOM proposal. We identified that, even where the literature was strongly of the view that privatisations led to significant efficiency gains, it may have been of only partial relevance to the New Zealand experience.

4. The OECD[2] summarised the impact of privatisation on corporate efficiency and performance:

   Despite the data and methodological difficulties noted above there is overwhelming support for the notion that privatisation brings about a significant increase in the profitability, real output and efficiency of privatised companies. The results on improved efficiency are particularly robust when the firm operates in a competitive market, and that deregulation speeds up convergence to private sector levels. The studies also report that:

   - *Profitability increases more and productivity increases less in regulated or less competitive sectors.*
   - *Fully privatised firms perform better than partially privatised ones. Cross-country studies report smaller profitability gains and productivity changes as compared to fully privatised ones.*

5. From this base, however, we asked the following questions:

   - How applicable are these results to New Zealand? Is the starting condition of the state enterprises in these studies reflective of New Zealand's state owned enterprises?
   - Is the scepticism in the literature regarding the ability to improve enterprise performance while retaining government ownership reflective of New Zealand's experience?
   - What is the influence of other policy interventions such as regulatory and competition policy? Is ownership actually the main influence of the poor performance of these entities?

6. The theme in the literature is one of state enterprises that are highly indebted, inefficient, over-staffed, and loss-making enterprises, protected from competition, deliberately under-pricing their products for political reasons, and imposing significant pressure on government finances. Fiscally strained governments are unable to provide capital to the state enterprises for maintenance or for expansion, leading to a lack of access to services for poor and rural consumers. Privatisation is argued to reverse many, if not all, of these negative outcomes.

7. For example, consider the following quotes[3]:

   [Inefficient state enterprises led to] … financial losses that in acute cases amounted to as much as 5 to 6 percent of gross domestic product annually.

---

1 Impacts on the goals of improving government's fiscal position and deepening capital markets will tend to be self evident given the size of the companies and the choice of IPO as the sale method.

2 OECD (2003)

3 All quotes are from Kikeri & Nellis (2004).

La Porta and Lopex-de-Silanes … conclude that state enterprises went from being highly unprofitable before privatisation to being profitable thereafter

In Brazil … before privatisation, the ratio of profits to net assets was negative, averaging –2.5% and falling to –5.4% toward the end. The large steel mill, which had been incurring heavy losses, became profitable and investment increased dramatically.

Losses in the Chilean electricity sector … more than halved after privatisation . . .

In Sri Lanka … estimated redundancy in eight of the largest firms (in electricity, railways, shipping, sugar, cement, and petroleum) averaged 53 percent

Prior to privatisation, Argentine railways, with more than 90,000 employees, had a wage bill equivalent to 160% of the firm's total revenues

8. In our view, these kinds of enterprises did not reflect the New Zealand experience. New Zealand's SOE framework has been successful in corporatising the entities involved, with commensurate gains in efficiency. Efforts to benchmark the performance of New Zealand SOEs against private sector comparators has tended to conclude that there is little evidence of systemic under or over performance in the SOE portfolio. Turning to electricity SOEs in particular, data on access to investment capital, service provision, efficient pricing, and the quality of investment decision making all indicated that performance had been adequate.

9. Separately, successive New Zealand governments have also been able to undertake a wide range of regulatory reforms including competition policy, labour markets, and a sector specific regulatory regime for electricity. The literature agrees that improved performance of SOEs is driven by broader regulatory reforms as well as privatisation but argues that privatisation is a proxy for this array of reforms because in many countries governments are unable to undertake the necessary reforms in the absence of privatisation[4]. Our argument is that New Zealand has been able to undertake a range of reforms and that the performance of New Zealand SOEs already reflects these improvements. In New Zealand's case, the MOM IPOs will tend to complete the picture by adding capital market disciplines and direct price signals on performance. It was on this basis that we indicated to the government in our initial advice on the MOM proposal that the *economic efficiency* benefits of implementing MOM would be modest (recognising, of course, that overall benefits would be greater once other goals such as fiscal, capital markets etc were considered).

What to do with this Report

[4]

[5]

[5]

Recommended Action

We recommend that you:

a. **note** the contents of this report and the attached paper, and

b. **forward** it to your communications staff.

Andrew Blazey
Manager, Commercial Transactions Group

Hon Tony Ryall
Minister for State Owned Enterprises

Deutsche Bank

Confidential

Asset sale case studies

March 2012

Passion to Perform

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Section 1

Introduction

Introduction

1.1. Purpose

This analysis provides a survey of research literature on government asset sales in five geographies.

For each geography, it provides a summary of, the assets that have been sold, the method of sale and commentators' views on the success of the asset sales.

The geographies have been selected based on the similarity of the asset sale programmes to the MOM programme and the availability of relevant data and quality research.

At the beginning of this paper, we make some observations on global government asset sale trends and overall economic success of global asset sales based on the views of leading commentators.

1.2. Global government asset sale trends

Asset sales are a policy that came to prominence in the late 1970s and in the following four decades has been used around the world with over 130 countries selling at least 75,000 medium and large enterprises formerly owned and operated by the state. It is estimated that, since inception, asset sale programmes have effectively halved worldwide state ownership of assets[1]

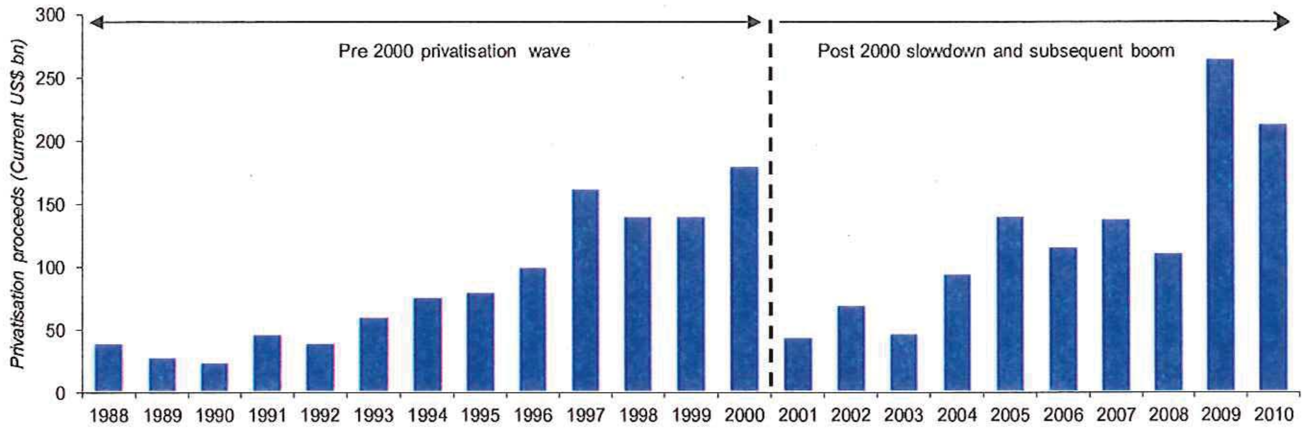
The most common rationale for pursuing asset sales in developed nations has been to address industrial competitiveness and also ease fiscal demands on the state. Also, several formerly socialist countries have used asset sales to assist their transition to a market based economic system. Asset sales have occurred across numerous sectors: including infrastructure (e.g. telecommunications, water and sewerage, electricity generation and distribution, ports, airlines), banking, insurance, tourism, industrial companies and services.

Sales volumes have ebbed and flowed in the past three decades:

- In the 1980s and 1990s there was a high volume of asset sales as many OECD nations undertook their first stage of sales of large companies in formerly nationalised industries and formerly socialist countries undertook massive sales of thousands of small and medium sized enterprises
- In the period 2000-2004, asset sales in OECD countries tapered off. The reason for this slow down was the drop world equities markets following the burst of the technology bubble in September 2000 and also that many of the more saleable entities had already been divested
- For the period 2005-2008, global asset sale proceeds rebounded considerably returning close to late 1990s levels
- In both 2009 and 2010, record proceeds were achieved due to several large share sales of SOEs in the EU, China, Brazil and Malaysia. As a result of the 2008 GFC, there was also a large amount of equity within the automotive and financial industries temporarily taken into state hands by the US Government
- The GFC will be the catalyst for another global surge in government asset sales. Many heavily indebted, low-growth countries have few de-leveraging options other than to divest their remaining SOE portfolios. In some cases, external funders are demanding the sale of state-owned firms to improve government balances and justify financial assistance

[1] Boutchkova and Megginson, 2000

Worldwide Privatisation proceeds 1988 - 2010



Source: Privatisation Barometer

1.3. The success of privatisation

Initial research during the 1980s and 90s typically focussed on assessing performance before and after sale using a variety of analytical techniques. This research analysed several regions and examined firms in a variety of sectors.

The general assessment of this body of research was that ownership change contributed positively to firm performance. In 1998, a comprehensive survey of the empirical literature on asset sales by Megginson & Netter states:

"The evidence is now conclusive that privately owned firms outperform SOEs [state-owned enterprises]... empirical evidence clearly shows that privatization significantly (often dramatically) improves the financial and operating performance of divested firms."

The key findings of that report across various dimensions of performance are summarised below:

Key findings

Government share of GDP	– Asset sale programmes have significantly reduced the role of SOEs in most countries economies – The SOE share of "global GDP" has declined from more than 10% in 1979 to less than 6% in 2000
Efficiency	– Research supports the conclusion that privately owned firms are more efficient and more profitable than otherwise-comparable state-owned firms – However, there is little empirical evidence on how asset sales affects consumers
Employment	– Most studies find that employment in privatised firms usually does fall
Methods of privatisation	– Governments use three basic techniques to privatise their SOEs: – share issue offerings; – direct trade sales; and – voucher or mass sales
Share issue offerings	– Most governments underprice share offerings (particularly initial offerings) and then use targeted share allocations to favor domestic over foreign investors – SOE employees are particularly favored, receiving preferential allocations in 91 percent of offers

Source A survey of empirical studies on privatization (1998, Megginson & Netter).

Key findings (continued)

[6]

Capital market development	– It is difficult to pinpoint causality, but it appears that countries that have launched large-scale share issue offerings have experienced rapid growth in their national stock market capitalisation and trading volume
Corporate governance	– Emerging (largely anecdotal) evidence suggests that adopting a large-scale share issue offerings can be a major spur to modernising a nation's corporate governance system

Source A survey of empirical studies on privatization (1998, Megginson & Netter).

Some later research (post 1998) has focussed on not only relative financial performance but also on the impact of asset sales on an overall cost/benefit basis. Some of this research argues that the initial research during the 1980s and 90s often ignored economic cycles and the fact that asset sales were a policy generally implemented alongside broader economic reforms that encouraged economic growth and competition. Also, the only companies where performance data was generally available for research post sale were usually the largest and most profitable SOEs and therefore the sample was subject to selection bias.

Overall, this post 1998 research remains supportive of the conclusion that asset sales do contribute positively to overall economic welfare, but observes that the benefits may not be as straightforward as first thought. This view is summarised by John Nellis in his paper *The International experience with Privatisation: Its Rapid Rise, Partial Fall and Uncertain Future, 2012* which undertakes a survey of recent studies:

"Economic analysts presently take a more balanced view of its effectiveness. Few dispute the positive results of privatization of firms operating in competitive, or potentially competitive markets, but experience has yielded a deeper understanding of the complexities of implementing the policy, especially in infrastructure sectors such as electricity, railways or water and sewerage, and particularly in lower-income, less developed economies. There is a greater recognition that privatization needs to take place in a supportive institutional and policy framework if it is to live up to its potential; and there is a better realization of the socio-political challenges that inevitably accompany this always contentious activity. This is not to say that past privatizations were mistakes, or that previous analyses were in error. Rather, it is that the early, often excessive enthusiasm for, and overselling of, the policy has been replaced with a more nuanced view of its strengths and weaknesses."

The key findings of this paper are outlined below.

Key findings

Economic benefit

- In the main, studies confirm that in industries sold by governments there is evidence of increased efficiency (usually labour efficiency) increased output, increased investment and higher returns to capital
- Selling governments usually gained from asset sales through sales proceeds, a decrease of financial assistance to loss-making SOEs and an increase in corporate taxation
- Most welfare studies reported economic gains to society as a whole
  - A number of these studies concluded that unequal distribution of economic gains was actually far less severe than anticipated
  - However many also reported losses for labour, as workforce reductions are common and large, both in the run-up to and after the conclusion of the transactions

Source: International Experience with Privatization: Its Rapid Rise, Partial Fall and Uncertain Future

Key findings (continued)

Methods of privatisation	– Post-2000, asset sales through share issue offerings became a more important sale method – Share issue offerings and negotiated sales, through tenders and a variety of other case-by-case mechanisms, replaced voucher and management buy-out schemes as the most utilized sale procedures
Political constraints	– Many governments trying to improve efficiency and reduce the burdens imposed by loss-making or underperforming SOEs now approach asset sales very gingerly – In trying to design their programs to avoid perceived political problems, they often constrain the new private owners/managers in ways that hinder the achievement of the hoped for gains – As British Rail and other cases demonstrate, half-hearted or half-implemented reforms tend to produce a worst-of-both-worlds situation

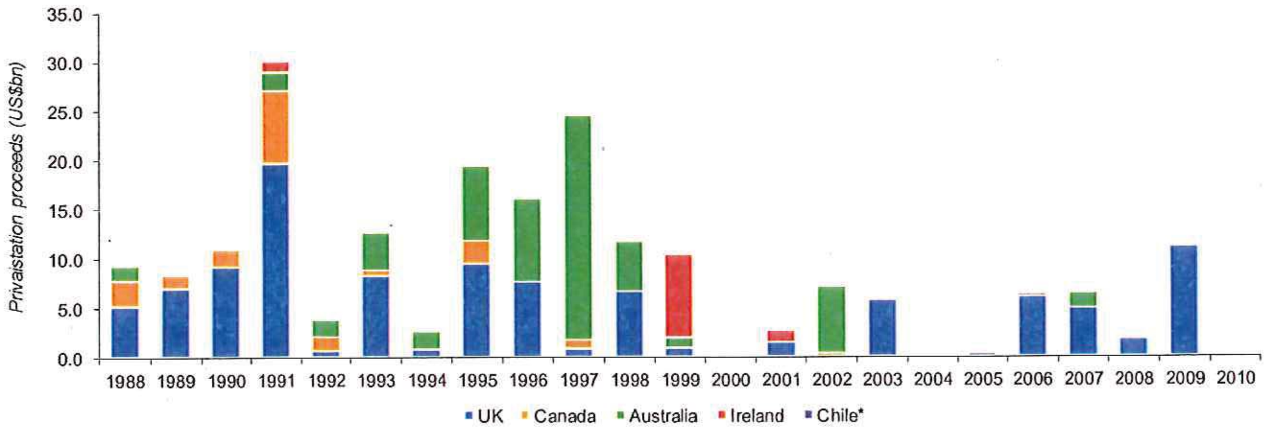
Source: International Experience with Privatization: Its Rapid Rise, Partial Fall and Uncertain Future

1.4. Selected case studies

The five countries selected as case studies represent a very small portion of global asset sales proceeds of US$2.3 trillion from 1988-2010:

- The UK has had the largest and most consistent asset sale programme with the majority of its sales taking place in the 1980s and 1990s.
- Australia has also sold a relatively large amount of assets, with total sale proceeds dominated by the Telstra share offers of the late 1990s and early 2000s.
- Canada's asset sales primarily occurred in the 1980s and 1990s with very few transactions taking place since then.
- Ireland has sold the fewest assets (a reflection of its small size) and its proceeds from asset sales are dominated by the sale of a cornerstone stake in and then IPO of Eircom in the 1990s.

Selected country privatisation proceeds 1988 - 2010



Source: Prvatisation Barometer, research articles
*No consistent data set is available for Chile

We consider that the countries which have the greatest relevance to the MOM programme are Canada, Australia and the UK. This is due to how their programmes have been undertaken, in particular the large number of share issue offerings which have been used and also the type of assets sold.

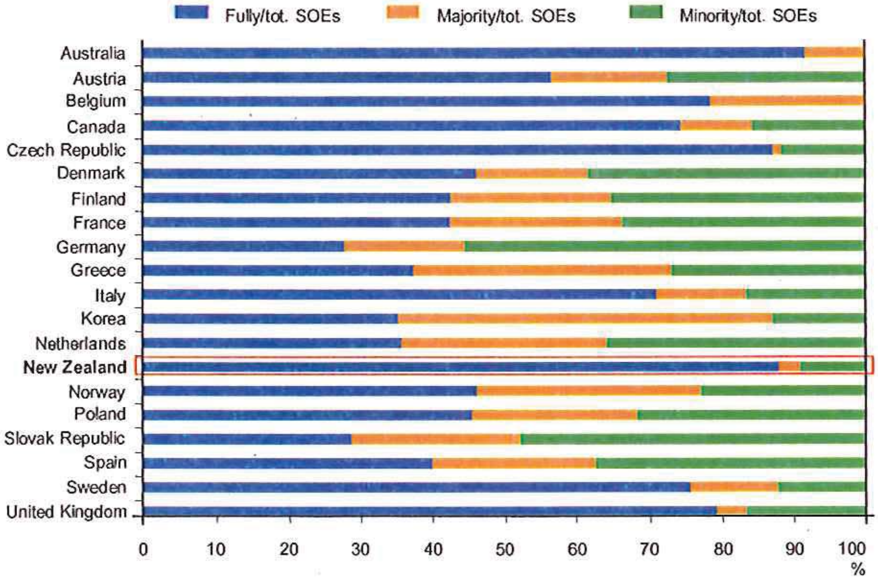
1.5. Mixed ownership analysis

In reviewing this topic, we have not found any paper that specifically analyses SOEs which have been partially listed.

Of the five countries selected as case studies, Canada, Australia and the UK have sold all of their remaining stakes in partially listed SOEs (the UK still holds stakes some re-nationalised financial institutions). Ireland only has one remaining stake (25% stake in Aer Lingus). There is incomplete information available on Chile.

Within the broader OECD SOE universe, approximately 50% are 100% owned by the government. A further 20% are majority owned.

Level of state ownership in SOEs

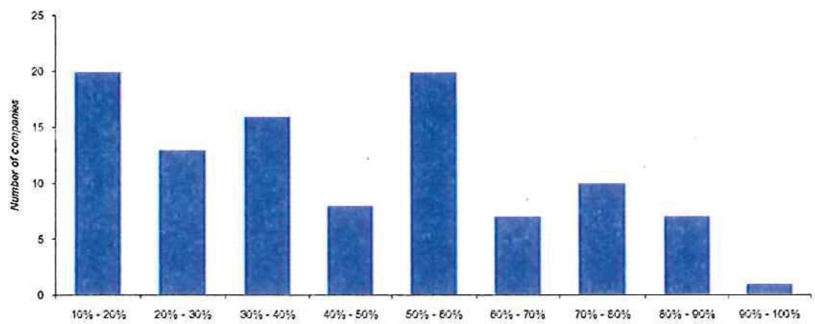


Source: OECD

Only 10% of SOEs are partially listed in OECD countries. A few countries are well above the average, such as Norway and Finland, where 20-25% of SOEs are partially listed. New Zealand is an outlier with its one listed SOE (Air NZ) representing only 2 to 3% of the total value of all SOEs[(2)].

Within the listed SOE universe there is a wide range of ownership level held by respective governments.

Level of state ownership in SOEs



Source: OECD

(2) Corporate Governance of State-Owned Enterprises – a survey of OECD Countries, OECD, 2005

Section 2

Canada

Canada

Key takeaways

i. In Canada, asset sales have been used primarily as a tool to manage the government's fiscal position

ii. Assets sold have primarily been large scale companies that operate in competitive markets across a range of sectors including telecommunications and transportation infrastructure, natural resources and oil & gas with few regulated infrastructure assets

iii. Public share offers have been used as the primary method of sale, in particular for large scale assets. Direct sales have typically been used for smaller more niche companies

iv. Asset sales have been successful with most companies sold via public offers having improved operational efficiency and profitability, while also continuing to pay significant taxes

v. After a pause of more than ten years, the Canadian government has recently undertaken a small sale and may be considering the divestment of more assets

2.1. Introduction

The majority of Canadian asset sales both at federal and provincial level occurred during the 10 year period from the mid-1980s to the mid-1990s under the conservative Mulroney government. This followed the example set by the Thatcher government in the United Kingdom. Sustained attempts at asset sales were made with a concerted attempt to reduce number of state enterprises at the federal level. The purpose was raise funds to help control annual deficits and the national debt. The Liberal government elected in 1993 supported asset sales and continued the federal programme (albeit at a slower rate) while provincial governments lost interest in privatisations post 1993 (only four have taken place from 1993 to 2012).

The majority of the entities sold operated in competitive markets. They represented the most readily 'saleable' assets that federal and provincial governments had available. Both direct sales and public share offers were used to sell assets.

2.2. What assets have been sold?

The federal and provincial governments have sold over 50 entities between them with the variety of assets held reflected in the assets sold. Of the top ten assets sold (which make up 72% of total proceeds) there is no obvious bias towards any sector.

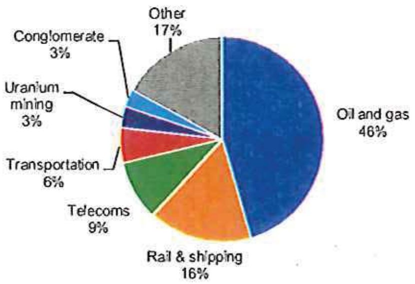
Top ten federal and provincial privatisations (by sector)

Date	Company	Sector	Former Owner	Proceeds (C$M)
1991	Petro-Canada	Oil and gas	Canada	5,693
1995	CNR (Canadian National Railway)	Rail shipping	Canada	2,079
1990	Alberta Government Telephones	Telecommunications	Alberta / Canada	1,766
1989	Potash Corporation of Saskatchewan	Potash mining	Sask. / Canada	1,237
1991	Cameco	Uranium mining	Sask. / Canada	1,081
1997	Manitoba Telephone Systems	Telecommunications	Man. / Canada	860
1992	Nova Scotia Power Corp	Electricity generation	N.S. / Canada	816
1988	BC Hydro's natural gas division	Natural gas distribution	B.C. / Canada	741
1988	Air Canada	Transportation	Canada	708
1987	Teleglobe Canada	Telecommunications	Canada	612

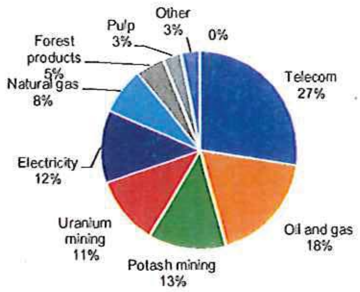
Source: A Review and Assessment of Privatisation in Canada, Boardman & Vining (2012)

By value, most of the Federal government's asset sales were in the oil & gas and rail & shipping sectors, with the oil and gas sector and more specifically the Petro-Canada transaction making up nearly 50% of total federal asset sale proceeds. Provincial asset sales have been more diverse in sector composition and often depend on the specific resources and features of an individual province. By value, most of the provincial asset sales were in the telecommunications and oil & gas sectors.

Federal privatisation proceeds by sector



Provincial privatisation proceeds by sector



Federal privatisations by sector

Sector	Proceeds (C$m)	No. of transactions
Oil and gas	5865	3
Rail & shipping	2099	2
Telecoms	1217	4
Transportation	708	1
Uranium mining	444	1
Conglomerate	361	1
Other	2175	18
Total	**11969**	**30**

Provincial privatisations by sector

Sector	Proceeds (C$m)	No. of transactions
Telecom	2664	3
Oil and gas	1798	6
Potash mining	1237	1
Uranium mining	1081	1
Electricity	1156	2
Natural gas	741	1
Forest products	452	2
Pulp	300	1
Other	296	6
Total	**9725**	**23**

Source: A Review and Assessment of Privatisation in Canada, Boardman & Vining (2012)

2.3. What sale methods were used?

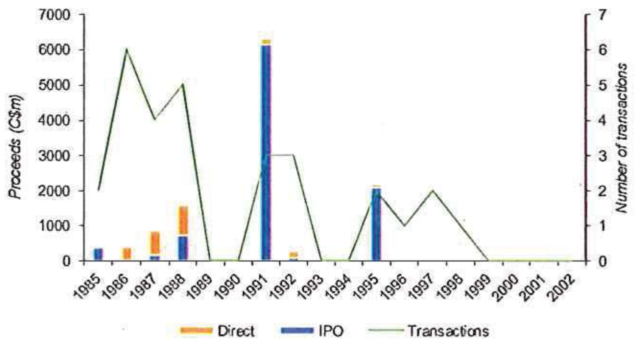
Canadian governments have used both direct sales and public share offerings. Direct sales have been typically been used for smaller assets that operate in more niche markets. As a method of sale they are more numerous by volume but not by value. Public share offerings have been used for the larger entities (make up eight of the top 10 privatisations) and represent by far the largest share of proceeds. Canadian government bodies have typically either sold their entire stake in one transaction or via a series of transactions with the result that today there are no former SOEs where a Canadian government retains a stake.

Top ten federal and provincial privatisations (by sale type)

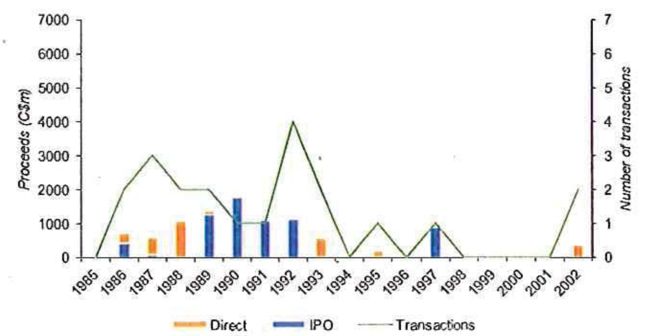
Date	Company	Sale type	Post privatisation owner	Proceeds (C$M)
1991	Petro-Canada	IPO	Four public offerings in 1991, 1992, 1995 and 2004	5,693
1995	CNR (Canadian National Railway)	IPO	Public offering	2,079
1990	Alberta Government Telephones	IPO	Two public offerings in 1990 and 1991	1,766
1989	Potash Corporation of Saskatchewan	IPO	Two public offerings in 1989 and 1991	1,237
1991	Cameco	IPO	Four public offerings 1991-2002	1,081
1997	Manitoba Telephone Systems	IPO	Public offering	860
1992	Nova Scotia Power Corp	IPO	One public offering	816
1988	BC Hydro's natural gas division	Trade	Inland Natural Gas	741
1988	Air Canada	IPO	Two public offerings in 1988 and 1989	708
1987	Teleglobe Canada	Trade	Memotec Data Inc. (qualified auction)	612

Source: A Review and Assessment of Privatisation in Canada, Boardman & Vining (2012)

Federal privatisation methods (1985-2010)



Provincial privatisation methods (1985-2010)



Source: A Review and Assessment of Privatisation in Canada, Boardman & Vining (2012)

2.4. Has privatisation been successful?

In 2012, Boardman and Vining analysed the performance of Canadian privatised companies pre and post privatisation.

A Review and Assessment of Privatisation in Canada (2012, Boardman & Vining)

This paper examines Canadian privatisations (both Federal and Provincial) from the 1980s to the present with the objective of understanding the social welfare impact of privatisation. The performance of Canada's share issue privatisations (SIP) are examined by measuring the changes in operating performance pre and post privatisation. One particular transaction (Canadian National Railway) is also specifically evaluated in order to make an estimate of the social welfare impact.

Pre and post-privatisation operational performance of SIPs

	Mean 5 Years Before	Mean 3 Years Before	Mean 3 Years After	Mean 5 Years After	Mean 17 Years After	Mean Change: 3 years before & 3 after	Mean Change: 5 years before & 5 after	Mean Change: 5 years before & 17 after
Growth								
Real Sales	1,455	1,426	1,336	1,442	2,974	-91	-13	1,520
Real Assets	2,395	2,335	2,300	2,686	5,308	-35	291	2,913
Real CAPEX	196	186	240	270	555	54	74	359
CAPEX to Sales	19.3%	17.9%	23.5%	23.9%	20.6%	5.6%	4.6%	1.3%
CAPEX to Assets	8.8%	8.3%	10.2%	10.5%	9.9%	2.0%	1.7%	1.1%
Employment								
Number of Employees	10,614	9,245	7,809	7,608	9,274	-1,437	-3,005	-1,340
Operational efficiency								
Real Sales per Employee ($000s)	199	218	229	262	462	11	63	263
Real Net Income	18	17	69	82	222	52	64	204
Net Income to Sales (ROS)	4.3%	6.0%	8.7%	9.0%	8.6%	2.6%	4.7%	4.3%
Net Income to Assets (ROA)	2.3%	2.9%	3.4%	3.4%	3.3%	0.5%	1.1%	1.0%
Real Dividends	19	17	35	40	69	18	21	50
Dividends to Sales	1.9%	1.7%	4.8%	4.7%	3.9%	3.1%	2.8%	2.1%
Taxes								
Real Taxes	29	29	47	64	158	18	35	129

Source: A Review and Assessment of Privatisation in Canada, Boardman & Vining (2012)

Key findings

Growth	– Sales fall as companies are being prepared for privatisation and their focus changes from social objectives to profit maximisation – Privatisation results in greater capital investment in a business and improved sales performance post privatisation
Employment	– A dramatic reduction in employment takes place prior to and immediately after privatisation as the company's workforce is restructured to reflect an increased emphasis on efficiency and profitability – This was common in most industrialised countries undertaking privatisations, but as a percentage change the reduction in Canada was much larger – Once companies complete restructuring, hiring begins again (usually about five years post privatisation)

Operational efficiency	– Labour efficiency improves significantly once employment restructuring is complete
	  – sales per employee increased an average of 9.1% per annum during the 17 years following privatisation
	– Profitability increases dramatically in the period immediately post privatisation, but then stabilises approximately 5 years after privatisation and experiences little or no growth after that
	  – Payment of dividends mirrors firm profitability payment increasing immediately after privatisation and then stabilising for the remainder of the period

Taxes	– Immediately after privatisation taxes paid to the government increased substantially and after that continued to grow consistently in the following 17 years post privatisation

Source: A Review and Assessment of Privatisation in Canada, Boardman & Vining (2012)

The conclusion of this research is that the privatisation of entities operating in competitive markets has been successful. Most company's privatised via public share offers have improved operational efficiency and profitability while continuing to provide considerable taxation revenues to the government.

The only two public share offer privatisations that could be deemed failures are Fishery Products International (FPI) and Air Canada. In respect of FPI, the collapse of the cod fishery was an external shock that had a significant negative impact. In respect of Air Canada, it operates in a highly volatile and often unprofitable industry. There is no evidence to suggest that if these companies remained government owned the outcome would had been any different.

2.5. Current state of the privatisation debate

In 2009, the then minority Harper government raised the possibility of selling a number of "not self-sustaining" Crown corporations. However there was little action until June 2011, when the commercial reactor division of Atomic Energy of Canada Ltd (AECL) was sold in a direct sale by the now majority Harper government. This sale was the first Canadian federal privatisation in 13 years and may indicate a renewed interest in privatisation by the federal government. At a provincial level, there are more saleable assets than at a federal level, but provincial governments have shown little appetite for privatisations, with the last one taking place in 2002.

Section 3

Australia

Australia

Key takeaways

i. Privatisation was initially used at a federal level to reduce budget deficits and control debt. Later, under the Howard Liberal government, the policy focus was more focussed at removing government ownership where the private sector could provide goods and services effectively. At a state level, privatisation has generally been used as a tool to reduce debt, with efficiency improvements a secondary consideration

ii. The majority of privatisation proceeds (both federal and state) have come from the sale of large scale infrastructure type assets (both regulated and unregulated). Telstra is by far the largest asset privatised

iii. Both direct trade sales and public share offers have been used to sell assets. Compared to other countries trade sales have been more prevalent in the sale of large scale assets

iv. The limited number of studies indicate privatisation has been positive for efficiency and profitability and has had mixed benefits for consumers. The recent privatisation of Queensland Rail is an example where significant cost out opportunities have been realised

v. The large scale share issue privatisations undertaken in the 1990s (in particular Telstra) have been credited with assisting the development of the Australian capital markets and increasing direct share ownership amongst the broader public

vi. Current privatisation initiatives continue to occur at state level. State governments continue to see asset disposal as a way to improve their fiscal positions which will continue to drive near term privatisation activity, particularly in New South Wales

3.1. Introduction

Privatisation in Australia began in the 1980s under a Labor government with a number of relatively small-scale sales. In the early 1990s the pace of divestment increased with the sale of large public enterprises including Commonwealth Bank, Australian Airlines and Qantas. These sales were aimed at reducing the budget deficit, addressing the growing debt problem, funding popular government programmes, and providing an avenue to escape future funding of capital expenditure.

In 1996, the Liberal government elected accelerated the number and scale of privatisations with the largest disposal of assets in Australian history occurring in the few years following the 1996 election. The divestment programme continued for a decade and raised approximately A$60bn (compared to c.$7bn during previous Labor government) before slowing considerably in the late 2000s.

During the 1990s and 2000s, state governments were also undertaking extensive privatisation programmes selling approximately A$40bn. Most recently Queensland has undertaken a privatisation programme to help repay debt and the NSW government has announced the sale of electricity assets.

3.2. What assets have been sold?

Privatisations under Labor were aimed more at reducing budget deficits and funding government programmes and as such there programme had relatively fewer sales but included a number of large 'iconic' public facing enterprises such as the Commonwealth Bank, Australian Airlines and Qantas. The Liberal government's privatisation programme was more ideological in nature and involved a large range of businesses where it was determined that the government was not the most efficient owner. States also sold a number of large assets including electricity, transportation and financial institutions.

The table below shows the top twenty assets privatised (which make up 87% of total proceeds). Apart from the sale of Telstra of there is no obvious bias towards any particular sector.

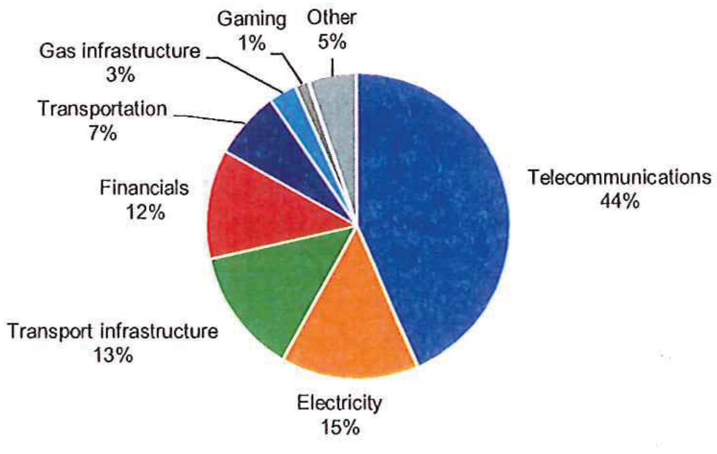
Top ten federal and state privatisations (by sector)

Date	Company	Sector	Former Owner	Proceeds (A$M)
1997	Telstra (3 tranches)	Telecommunications	Australia	46,330
1991	Commonwealth Bank (4 tranches)	Financials	Australia	8,138
2002	Sydney Airport	Transport infrastructure	Australia	5,588
1996	Loy Yang A	Electricity	Victoria	4,746
2010	QR National	Transportation	Queensland	4,049
1997	Powernet	Electricity	Victoria	2,555
1998	Dampier-Bunbury natural gas pipeline	Gas infrastructure	Western Australia	2,303
1995	Powercor	Electricity	Victoria	2,150
1993	Qantas	Transportation	Australia	2,115
2010	Port of Brisbane	Transport infrastructure	Queensland	2,095
1995	Eastern Energy	Electricity	Victoria	2,080
2011	Abbot point coal terminal	Transport infrastructure	Queensland	1,829
1995	Citipower	Electricity	Victoria	1,575
1988	Defence Service House Corporation loan portfolio	Real Estate	Australia	1,515
1997	Brisbane Airport	Transport infrastructure	Australia	1,387
1997	Melbourne Airport	Transport infrastructure	Australia	1,307
1992	NSW GIO	Financials	NSW	1,260
2007	Powerdirect	Electricity	Queensland	1,200
2002	National rail corporation and NSW freight corporation	Transportation	Australia/NSW	1,172
1998	NSW totalizator agency board	Gaming	NSW	1,000

Source: Reforming Public Procurement in Australia via Cost Sharing Incentives, Anthony & Evans (2010)

By value, the majority of Australia's privatisations have been in the telecommunications, electricity and transport infrastructure sectors. The telecommunications sector and more specifically the sale of Telstra makes up nearly 50% of total privatisation proceeds (the Telstra sale was executed over 3 tranches and 9 years). Much of the electricity sector proceeds are a result of the 1990s privatisation of the Victorian electricity industry. Transport infrastructure is primarily proceeds from the Federal government's stake in airports.

Federal and State privatisation proceeds by sector (1988-2011)



Source: Reforming Public Procurement in Australia via Cost Sharing Incentives, Anthony & Evans (2010)

3.3. What sale methods were used?

Australian governments have used both direct sales and public share offerings.

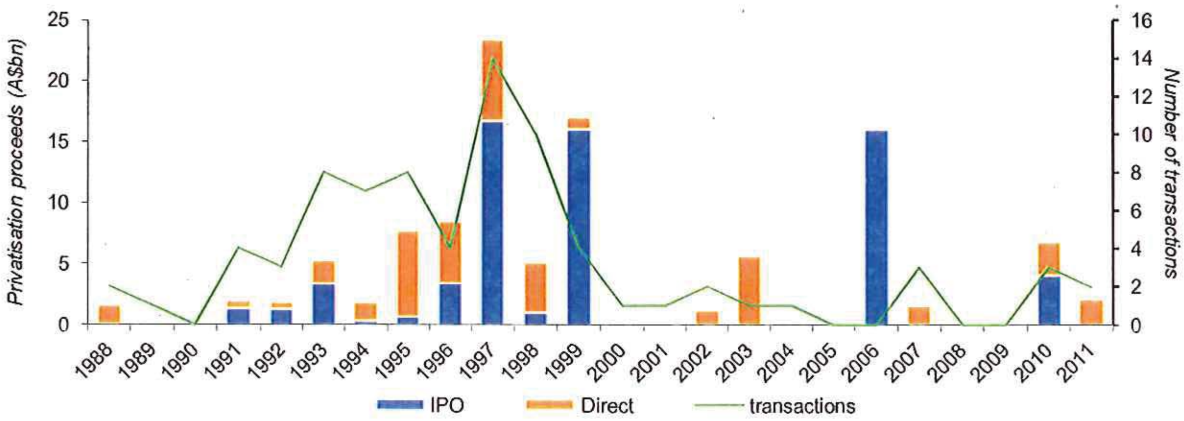
Compared to other jurisdictions, Australia has had more appetite to use direct sales for large assets. In aggregate, share offers represent 60% of total privatisation proceeds (excluding Telstra this drops to 31%). Direct sales have also been used for many smaller assets that operate in niche markets. Public share offerings have been used for the sale of several of the largest federal entities but they only make up 5 of the top 20 privatisations.

Top ten federal and provincial privatisations (by sale type)

Date	Company	Sale type	Post privatisation owner	Proceeds (A$M)
1997	Telstra	IPO	Three public offerings(1997, 1999, 2006)	46,330
1991	Commonwealth Bank	IPO	Four public offerings (1991, 1993, 1996, 1997)	8,138
2002	Sydney Airport	Direct	Southern Cross consortium	5,588
1996	Loy Yang A	Direct	GEAC consortium	4,746
2010	QR National	IPO	Partial public offering	4,049
1997	Powernet	Direct	GPU (General Public Utilities)	2,555
1998	Dampier-Bunbury natural gas pipeline	Direct	Epic Energy consortium	2,303
1995	Powercor	Direct	Pacificorp	2,150
1993	Qantas	IPO/Direct	British Airways / Public offer (1995)	2,115
2010	Port of Brisbane	Direct	QPort Holdings consortium	2,095
1995	Eastern Energy	Direct	TXU Energy	2,080
2011	Abbot point coal terminal	Direct	Mundra Port	1,829
1995	Citipower	Direct	AEP Resources	1,575
1988	Defence Service House Corporation loan portfolio	Direct		1,515
1997	Brisbane Airport	Direct	Brisbane Airport Corporation	1,387
1997	Melbourne Airport	Direct	Australia Pacific Airports Corporation Limited	1,307
1992	NSW GIO	IPO	Public offer	1,260
2007	Powerdirect	Direct	AGL	1,200
2002	National rail corporation and NSW freight corporation	Direct	Pacific National	1,172
1998	NSW totalizator agency board	IPO	Public offer	1,000

Source: Reforming Public Procurement in Australia via Cost Sharing Incentives, Anthony & Evans (2010)

Federal and state privatisation methods (1988-2011)



Source: Reforming Public Procurement in Australia via Cost Sharing Incentives, Anthony & Evans (2010)

3.4. Has privatisation been successful?

There is only limited research on Australian privatisation and this research does not have the same level of empirical focus on performance pre and post privatisation. Below is a summary of selected research.

Why privatisation? A review of the Australian experience (2003, King)

This paper reviews privatisation as a policy in Australia, the reasons for its implementation and review of its performance in three case studies. The paper concludes that the privatisation of the Commonwealth Bank and Victorian electricity system were successful. However it also observes that the Victorian privatisation did not remove political influence and that the privatisation of Telstra was poorly implemented from a competition/regulatory perspective.

Key findings

The Commonwealth Bank	– Deregulation of the Australian banking sector in the 1980s meant that there was little if any special role remaining for State-owned commercial banks
	– In terms of economic welfare the sale of the Commonwealth Bank made sense
	  – The bank operated in active competition with private banks and its functions were essentially identical to those of private competitors
	  – it is likely that continued government ownership of the Commonwealth Bank would have opened it up to political exploitation in the 1990s

Telstra	– The privatisation of Telstra failed to adequately recognise the source of market failure – Telstra's monopoly ownership of the customer access network 'CAN' (the 'last link' in the telephone network). Neither did it establish appropriate procedures to deal with this problem
	– Telstra faced a wide range of regulations, including retail price controls, procedures for setting wholesale access prices and rules to prevent any anticompetitive behaviour
	  – This regulation continued to be modified and in 2001 the Productivity Commission recommended further reform of Telstra's regulatory regime (Commonwealth of Australia 2001)
	  – In 2002 the Federal Government investigated and rejected reforming Telstra by accounting separation to 'isolate' the CAN (Eventually the government did separate Telstra)

Victorian electricity system	– Privatisation was preceded by vertical and horizontal restructuring, including the creation of five distribution/retail companies, five competing generation businesses and a single transmission business – By separating generation from transmission and distribution, the Victorian electricity privatisations avoided the issues of access and competitive abuse that have occurred in telecommunications – Some measures of performance, such as the reliability of the distribution system, have significantly improved – Political interference can still occur, in 2001 the Victorian Government rejected recommended increases in household power prices, leading to concerns over the long-term viability of distributors/retailers if they are unable to pass on increased wholesale electricity prices to customers – The Victorian electricity experience shows that privatisation is not a cure for short-term political interference in key infrastructure assets

Source: Why privatisation? A review of the Australian experience (2003, King)

A Brief Analysis of the Benefits of Privatising Victoria's Electricity Industry (2001, Institute of Public Affairs Ltd)

This paper examines the economic impact of the privatisation of the electricity industry in Victoria from 1994 to 1999 which involved the breakup, corporatisation and privatisation of the State Electricity Commission of Victoria (SECV, the state owned electricity utility). It concludes that the restructuring and privatisation of the sector had a number of benefits including productivity improvements, network reliability improvements and a reduction in electricity prices (despite increasing demand).

Key findings

Productivity	– During the 1990s total employment in the industry halved while Gross Product for the sector did not change resulting in a productivity increase for the decade of over 70% – Utilisation of brown coal power plants (Victoria's cheapest form of non-renewable fuel based generation) increased from 67% in 1995/96 to 84% by 1998 and displaced gas fired production – changes in the generation mix further illustrate how privatisation increased the productivity of capital

Reliability	– System reliability improved dramatically
	  – By 1999 there were nearly half as many unplanned outages as in 1995
	  – Overall minutes off supply (both planned and unplanned) had significant falls from 1995 to 1999

Pricing and Demand	– From 1992 to 2000 the average commercial price has decreased by almost 40 percent (to some extent the decreases were due to reductions in the cross subsidisation of residential users by commercial users)
	– Residential electricity prices have been falling since they peaked in 1994
	  – This has been achieved through efficiency improvements in generation, transmission and distribution largely due to deregulation and privatisation that have allowed reductions in electricity charges over the decade
	– From 1990 to 2000 total consumption increased by 7,000 GW hours, while aggregate prices have been falling since 1992 with the sharpest decline occurring between 1996 and 1998 (where average annual decreases were nearly six per cent)
	– Both capital and labour productivity increased over this period allowing additional demand to be met while prices continued to fall
	  – without the additional increases in capacity utilisation new capacity would have been required to satisfy the demand increases

Source: A Brief Analysis of the Benefits of Privatising Victoria's Electricity Industry (2001, Institute of Public Affairs Ltd)

Privatisation: A Review of the Australian Experience (2002, Committee for Economic Development of Australia)

This report contains the views of Australia's leading economists, policy advisers and public commentators on the effectiveness of privatisation programs in Australia. Most commentators contributing to the article agree that privatisation is beneficial in competitive markets. However, it is less obvious that this is the case with natural monopolies. For consumers the paper concludes that there have been mixed benefits.

Key findings

Competition & Efficiency	– Most economic commentators agree that privatisation is beneficial when it results in private firms operating in a competitive market

Monopoly assets & regulation	– The case for private ownership of natural monopoly assets remains contentious
	– In some areas (including parts of the transport sector, the transmission and distribution business in the energy sector and some other infrastructure services) competition may not be viable
	  – In these areas governments can intervene through a variety of combinations of regulation and ownership. Privatisation is about designing a mix of ownership and regulation to achieve an optimal outcome
	  – There are several examples of regulated assets being privately owned

Employment	– The overall impact of privatisation in competitive markets has been beneficial – Privatisation has been one of many factors driving the growth of part-time, casual and temporary employment
Consumer benefits	– From a consumer perspective, the overall verdict on privatisation is one of mixed success, with insufficient attention to consumer outcomes – Privatised industries argue there have been service improvements, although removing cross-subsidies has sometimes reduced consumer price benefits

Source: Privatisation: A Review of the Australian Experience (2002, Committee for Economic Development of Australia)

Privatisation in New Zealand and Australia: an empirical analysis (2005, Kerr, Qiu & Rose)

The paper investigates the long-run performance of privatised initial public offerings (IPOs) and their effects on the New Zealand share market (NZSE) and the Australian share market (ASX). The Australian privatisations included in the study occured between 1991 and 2001. Overall, it concludes that that privatisation has been positive to capital market development in New Zealand and Australia.

Key findings

Total market capitalisation	– In Australia, the total amount of privatisations increased from US$1.3bn in 1993 to US$70bn in 2001, while the total share market capitalisation increased from US$110bn to US$365bn – Privatisations played an important role in the increase in market size and the most important was Telstra which represented approximately 10 per cent of ASX capitalisation upon listing
Liquidity	– In Australia the percentage of its privatised portfolio market capitalisation that changed hands (liquidity ratio) increased from 15.1% in 1991 to 46.1% in 2001 – Both the liquidity of the privatised portfolio, and the liquidity of the total market in each country increased significantly over time, however in Australia the relationship was not found to be statistically significant
[6]	

Source: Privatisation in New Zealand and Australia: an empirical analysis (2005, Kerr, Qiu & Rose)

3.5. Recent developments

Recently, privatisation activity has been focussed at state level. Over the past two years the Queensland Government has undertaken a disposal of five assets that have raised c.A$15bn of proceeds. The NSW government has also recently announced that it intends to sell further electricity generation assets, but will retain control of distribution assets.

Section 4

United Kingdom

United Kingdom

Key takeaways

i. The UK initially used privatisation as a tool to manage its fiscal position, however as the programme developed a wider range of benefits (greater efficiency, broad share ownership) were identified and used as rationale

ii. Assets across a range of industry sectors and market types were sold, initially assets were from competitive markets (manufacturing, energy etc) but eventually included monopoly utilities (water, electricity distribution etc)

iii. Public share offers have been used as the primary method of sale, in particular for large scale assets with direct sales used for smaller more niche companies

iv. Privatisation has led to profitability and efficiency gains for firms and service improvements for consumers. However it does require a competitive market or effective regulation to live up to its potential

v. Privatisation in the UK is currently focussed on the divestment of stakes held in financial institutions acquired during the GFC

4.1. Introduction

Privatisation in the UK began following the election of the Thatcher government in 1979. The privatisation initiative that followed under successive conservative governments was one of the world's first large scale privatisation programmes.

The initial reasoning for the sale of state-owned assets was the Government's need to raise funds to sustain high levels of public expenditure without further tax rises. However, once the budgetary pressures began to ease in the early 1980s, attention turned to the wider economic benefits. The economic benefits claimed were higher productivity in the private sector, widening share ownership (to create 'popular capitalism') and reducing the power of the trade unions[3]

Even after the conservatives lost power in 1997, privatisation continued under Labour government (despite their previous opposition to the policy), albeit at a slower pace and Public-Private-Partnerships were heavily promoted as a means for the private sector to assist in the delivery of public services.

Most recently, post the GFC and the renationalisation of a number of financial institutions, the focus of the government has been returning the nationalised assets to private ownership. At this point, part of the Northern Rock business has been sold via a direct sale and parts of the Royal Bank of Scotland plc are in the process of being sold as it reorganises itself under public control. The government has also been readying the Royal Mail for sale, however there is no certain timing on when it will be ready for the market.

4.2. What assets have been sold?

Initial privatisations from 1979-87 were assets that operated in largely competitive markets, including manufacturing (Jaguar, Rolls Royce, British Steel, British Aerospace), Energy (BP, Britoil, Enterprise Oil, British Gas), Telecommunications (BT, Cable & Wireless) and infrastructure (BAA, Associated British Port Holdings).

From 1987 to 2000 the majority of privatisations were utilities from the water and electricity sectors along with some additional port / transport companies, British Coal and National Air Traffic Services.

[3] Privatisation: Lessons from the UK (2007, Parker)

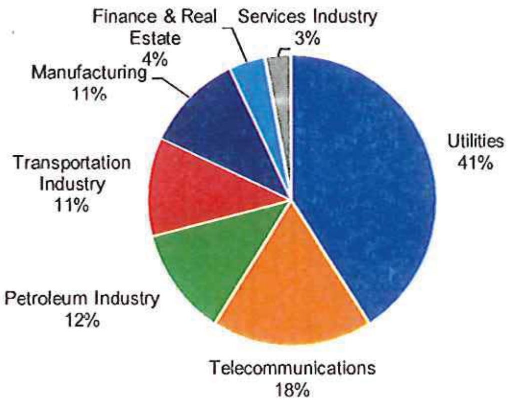
The UK's Major Privatisations, 1979-2001

Company	Date of sale (where more than one date is given the shares were sold in tranches)
British Petroleum	October 1979, September 1983, November 1987
British Aerospace	February 1981, May 1985
Cable & Wireless	October 1981, December 1983, December 1985
Amersham International	February 1982
National Freight Corporation	February 1982
Britoil	November 1982, August 1985
Associated British Port Holdings	February 1983, April 1984
Enterprise Oil	July 1984
Jaguar	August 1984
British Telecommunications	December 1984, December 1991, July 1993
British Shipbuilders and Naval Dockyards	1985 onwards
British Gas	December 1986
British Airways	February 1987
Rolls-Royce	May 1987
BAA (British Airports Authority)	July 1987
British Steel	December 1988
Anglian Water	December 1989
Northumbrian Water	December 1989
North West Water	December 1989
Severn Trent	December 1989
Southern Water	December 1989
South West Water	December 1989
Thames Water	December 1989
Welsh Water	December 1989
Wessex Water	December 1989
Yorkshire Water	December 1989
Eastern Electricity	December 1990
East Midlands Electricity	December 1990
London Electricity	December 1990
Manweb	December 1990
Northern Electric	December 1990
NORWEB	December 1990
SEEBOARD	December 1990
Southern Electric	December 1990
South Wales Electricity	December 1990
South Western Electricity	December 1990
Yorkshire Electricity	December 1990
National Power	March 1991
PowerGen	March 1991
Scottish Hydro-Electric	June 1991
Scottish Power	June 1991
Trust Ports	1992-97 (various dates)
Northern Ireland Electricity	June 1993
British Coal	December 1994
Railtrack	May 1996
British Energy	July 1996
AEA Technology	September 1996
Train Operating Companies	Various dates in 1996/7
National Air Traffic Services	July 2001

Source: Privatisation: Lessons from the UK (2007, Parker)

The chart below shows privatisation by industry from 1977-2009 (note excludes recent finance industry privatisations resulting from the GFC).

Privatisation proceeds by sector (1977-2009)

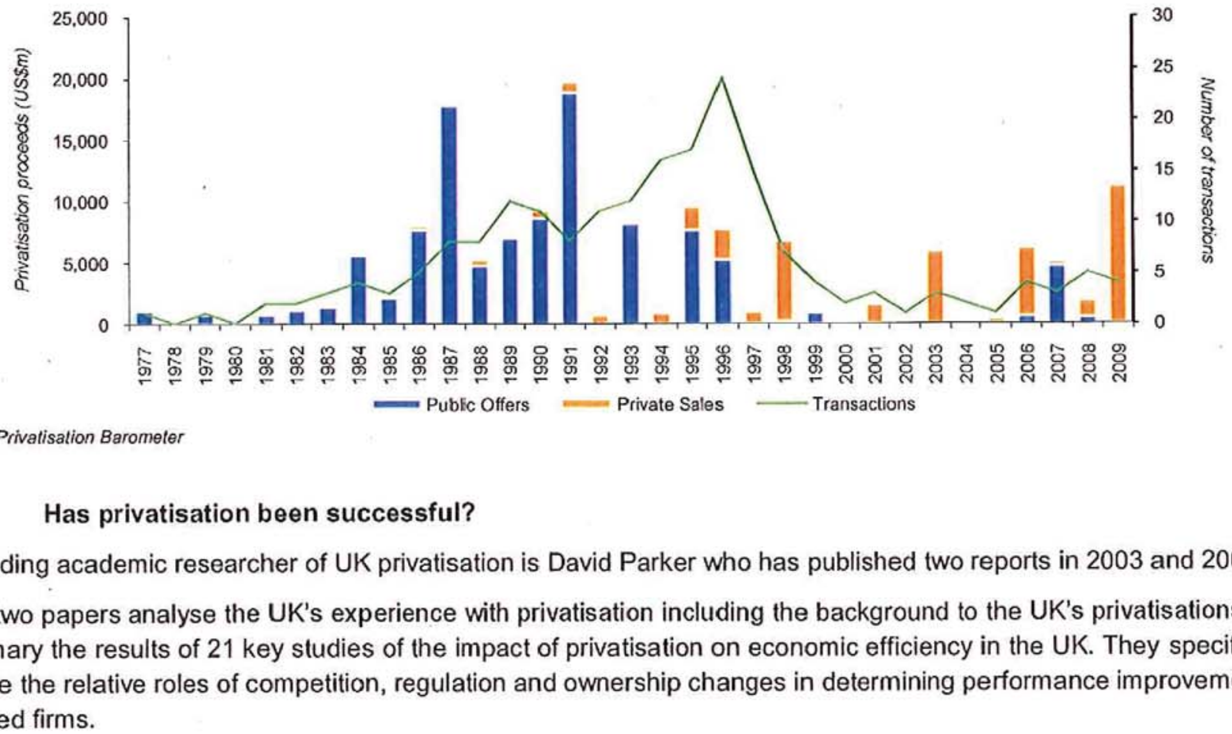


Source: Privatisation Barometer

4.3. What sale methods were used?

British governments have used both direct sales and public share offerings as the primary privatisation methods. Direct sales have been generally used for smaller assets while public share offerings have been used for the largest entities. The overall split (from 1977-2009) between public offers and direct sales based on proceeds is 71% / 29% with proceeds of US$104bn from public offers and US$42bn from direct sales. Public offers have come in the form of IPOs of 100% of a company or tranched selldowns for example a partial IPO followed by a 2PO of the Governments residual stake. The UK government has not undertaken any partial IPOs where it has not subsequently sold its remaining stake. Today the only listed companies where the UK government holds are partial stake are the financial institutions nationalised during the recent GFC.

Privatisation methods by value (1977-2009)



Source: Privatisation Barometer

4.4. Has privatisation been successful?

The leading academic researcher of UK privatisation is David Parker who has published two reports in 2003 and 2007.

These two papers analyse the UK's experience with privatisation including the background to the UK's privatisations and a summary the results of 21 key studies of the impact of privatisation on economic efficiency in the UK. They specifically examine the relative roles of competition, regulation and ownership changes in determining performance improvement in privatised firms.

The UK's Privatisation Experiment: The Passage of Time Permits a Sober Assessment (2003, Parker) & Privatisation: Lessons from the UK (2007, Parker)

Key findings

Competition & Efficiency	– Empirical evidence is consistent with economic theory and suggests that competition and in the absence of competition, effective state regulation are important if privatisation is to lead to performance improvements, including lower prices and improved services – Ownership change on its own does not appear to have a significant effect in terms of improving economic performance where there is market dominance, especially in terms of welfare gains to consumers – Privatisation has however been a catalyst that has improved competition and regulation of utilities in the UK, if it had not occurred it is likely that regulatory systems would have remained highly politicised and competition limited

[6]

Key findings

Industry regulation	– UK's experience that where firms are privatised with considerable market dominance developing effective regulation takes time, but is essential – A number of UK regulatory offices Oftel, Ofgas, Ofwat, Offer and ORR and their powers have evolved as utilities have been privatised and regulation has been required to extract efficiency gains
Consumer benefits	– Consumers in the UK have benefited from more competition and lower prices, especially for telephone calls and fuel – They have also benefited since privatisation from improved service quality – The UK's experience confirms that private profit making is not incompatible with good public services

Source: The UK's Privatisation Experiment: The Passage of Time Permits a Sober Assessment (2003, Parker) & Privatisation: Lessons from the UK (2007, Parker)

4.5. Recent developments

A new government entity, UK Financial Investments Ltd (UKFI) was established to hold banking assets acquired during the GFC. The task of this entity is to 'create and protect' the value for the government and to devise and execute a strategy for realising value of the investments in an 'orderly and active way'. To date, UKFI has sold the restructured and recapitalised Northern Rock business that holds and services all pre-existing customer savings accounts and some pre-existing mortgage accounts (the government still holds £66.3bn of former Northern Rock assets) and is in the process of selling parts of the Royal Bank of Scotland (RBS).

Legislation allowing Royal Mail to be privatised was passed in 2011 and whilst the company is being prepared for privatisation, this is unlikely to be ready until 2013. A number of operational and regulatory issues need to be addressed before the company is sold either via IPO or direct sale.

Section 5

Chile

Chile

Key takeaways

i. Privatisation in Chile began as a reversal of previous nationalisations, but rapidly became a policy used by the military government to improve economic performance. Privatisation was continued and its scope increased by subsequent democratic governments

ii. The scale of privatisation in Chile was very large. Assets of all sizes and across nearly all industry sectors and market types have been privatised

iii. Direct sales and public share offers have both been used

iv. Privatisation has resulted in significant improvements in profitability and productivity for privatised firms in particular those which operate in regulated markets

v. The privatisation of the electricity industry was a success, resulting in increased generation, lower prices and improvements in labour productivity for both generation and distribution firms

vi. The Chilean government has recently undertaken a sale of some of its partial (non-controlling) stakes in three water companies. One stake was listed and the other two sold via direct trade sales

5.1. Introduction

Chile was one of the first countries in the world to undertake a systematic privatisation programme. Privatisation was part of a broader process of economic liberalisation that took place post the 1973 military coup. Privatisation occurred in number of distinct rounds. The first round in the 1970s involved returning many businesses nationalised to by the prior socialist government to their original owners. This was followed in the 1980s by a more structured and transparent second round of privatising large portions of Chile's economy and many of the services traditionally provided by the government. The third round of privatisations in the 1990s were undertaken by the second democratically elected government and involved the sale of a number of regulated industries including water, electricity and telecommunications.

Most recently, the Chilean government has sold its residual ownership stake in three water companies that it had already partially privatised.

5.2. What assets have been sold?

During the first round of privatisation during 1974-80, approximately 260 firms[4] that were expropriated or illegally taken during the Allende administration were restored to their original owners. In addition the government also sold or liquidated an additional 118 firms acquired in the same period (retaining seven in that category) and 34 of the 65 pre-1970 government-owned firms were also privatised or closed.

Nationalisation and privatisation of firms

Number of firms	1970-73	1974-78	1979-83	1984-89	1990-2001
Beginning of Period	65	179	82	45	44
Acquired	113	1			
Created	1		10	29	12
Privatised		70	14	27	14
Liquidated		28	20	3	4
No Information			13		
End of Period	**179**	**82**	**45**	**44**	**38**

Source: The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

[4] The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

Privatisation during the 1980s was significant and most of the firms were utilities and included 14 electricity and three telecommunications companies (telecommunications privatisation continued in the 1990s). A number of banks re-nationalised in the early 1980s were also privatised during this period.

Revenues from Privatisation of Chilean Public Enterprises 1985-1989

(US$m)	**1985**	**1986**	**1987**	**1988**	**1989**	**Total**
13 Electric firms	16.4	124.3	393.0	632.5	77.9	1244.1
3 Telecom firms	0.9	55.6	35.5	344.0	192.1	628.1
Soquimich	4.7	85.4	71.5	60.9		222.5
Cap	12.1	139.5	53.2			204.8
Ecom	3.2	0.2			2.8	6.2
IANSA		8.8	1.0	50.8	8.0	68.6
Labchile		2.8	3.8	18.1	3.1	27.8
Schwager			6.1	2.2	7.0	15.3
Enaex		13.4				13.4
Isegen					5.6	5.6
Lanchile				7.0	75.9	82.9
Chilefilms				4.5		4.5
Isevida					8.8	8.8
Total	**16.4**	**430.0**	**564.1**	**1120.0**	**381.2**	**2532.6**

Source: The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

The first democratic government post the military regime halted privatisations, but the second restarted them with vigour. From 1994-2001 14 companies were privatised, including two shipping companies, two railway companies and the government's remaining 27% stake in LAN Chile airline. The privatisation of the electricity and telecommunications sectors was completed with three further sales. One of the most important developments at the time was liberalisation of the water and sanitation sector including the sales of the two largest water and sewage companies.

Finally in 2011, the government sold its remaining ownership stakes in three water and sewage companies to help fund reconstruction efforts.

5.3. What sale methods were used?

The three methods of privatisation that have occurred in Chile include:

- direct sales of either the whole firm or controlling stakes were sold in open international auctions
- the auction of non-controlling packages of shares on the stock market
- the direct sale of shares to the workers of privatised companies, public employees, and small investors (so called 'labour' and 'popular' capitalism)

Many telecom and electricity companies were privatised between 1985 and 1989. Some of the smallest companies were sold through public auctions. Larger firms were privatised through a variety of mechanisms including the sale of shares on the stock market, the periodic auction of packages of shares on the stock market, and the direct sale of shares to employees and small investors. Pension funds, company employees and foreign investors acquired most of the shares.

Privatisations in the 1990s used 100% direct sales for the small and more specialised transportation assets. Public share offers were used for the remaining electricity assets and some water assets. Partial direct sales were used for the privatisation of water and sewage companies.

5.4. Has privatisation been successful?

Privatisation in Chile has been part of a comprehensive economic liberalisation process that has also included the privatising of public pension schemes, partial privatisation of education and health insurance and the privatisation of new transportation infrastructure and seaport operations[5]. Also much of the privatisation and economic reform occurred while the country was controlled by an unelected military government that suppressed opposition.

The leading piece of research on Chilean privatisation was completed by Fischer, Guttierrez and Serra in 2003. In summary privatisation has resulted in significant improvements in profitability and productivity for privatised firms in particular those which operate in regulated markets.

The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

This paper provides a useful chronology of Chile's history of privatisation and provides an analysis on Chilean corporate privatisations with the goal of understanding the social welfare impact of the privatisation of these firms. Given the difficulty of finding a complete data set, this paper focuses on 54 firms privatised from 1979-2001 and analyses 37 of these companies in more detail. The key findings of this research are summarised below.

Key findings

Profitability	– On average, following privatisation profitability of firms increased significantly across a number of variables – However much of the increase in profitability is due to regulated firms – Once profitability of firms is normalised for the performance of the industry sector as a whole, the change in profitability of un-regulated firms is not significant i.e. it can be explained by the increasing performance of the industry as a whole, this in turn implies that these firms were already relatively efficient pre-privatisation – The normalised profitability of regulated firms increased post privatisation, these firms had average profitability similar to that of their sectors and became much more profitable afterwards, potentially indicating that regulators were unable to pass gains in efficiency on to consumers

Efficiency	– Efficiency (measured as cost per unit of sales and sales to PPE) fell by a small but statistically significant amount for the sample of privatised firms
	– Once these changes in efficiency are normalised for changes in each sector the results are different
	  – The cost per unit of sales measurement changes at the same rate as the rest of the industry (for both regulated and unregulated companies)
	  – Changes in sales to PPE are much higher than the average for each company's given industry sector

Investment	– The investment to sales ratio (I/S) fell after privatisation, which could imply that firms invested more productively or that SOEs operating in a competitive setting were investing efficiently before privatisation so there was little scope for improvement – The ratios of investment and physical assets per employee increased substantially after privatisation and on this measure un-regulated firms actually had a more significant increase – Once measures of investment are normalised for sector investment it shows there are few changes to behaviour that can be attributed to privatisation rather than the industry, the only significant difference is that investment to PPE ratios of regulated companies were significantly higher than the average for their sector
Productivity	– Labour productivity increased significantly as firms became private (although due to data constraints it was not possible to measure this on a normalised basis) – Once again, most of the change was due to the behaviour of regulated firms, with sales to employment ratios increasing by 88% and operating income to employment ratios rising by 325% – Firms also increased their physical productivity by about 25% on average after privatisation, but this data is by its nature very hard to measure with many firms having more than one line of production, and therefore a change in physical productivity on the basis of one product may mean nothing.
Employment	– There appears to be little evidence that firms fired workers during the period post privatisation, in fact it appears that firms took on more workers on aggregate (no difference between regulated and unregulated firms) – However, it is clear that SOEs reduced their employment levels several years before they were privatised (more than three years in most cases)

Source: The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

[5] The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

Electricity sector privatisation in Chile

The privatisation of the two largest electricity companies (ENDESA and Chilectra) started in 1986. Fischer, Gutierrez & Serra noted that in order to create competition in the wholesale electricity market, they were restructured prior to privatisation. The restructuring involved separating distribution from generation. ENDESA, the largest company, was divided into 14 companies: six generating companies, six distribution companies, and two small isolated companies combining generation and distribution in the southern part of the country. Chilectra was divided into three firms: a generating company, and two distribution companies. Most of the firms were under private control by 1989.

A analysis of electricity sector privatisation and key findings are outlined below.

Privatisation of Electric Companies 1984-1989 (US$m)

Sector/Company	1985	1986	1987	1988	1989	Total
Distribution						
Chilmetro	10.0	36.0	83.3			129.3
Chilquinta	2.4	11.1	18.7			32.2
Emec		6.0	7.5			13.5
Emel		7.9				7.9
Emelat			9.7	0.9		10.6
Emelari					3.1	3.1
Eliqsa					4.8	4.8
Elecda					6.1	6.1
Generation						
Endesa			180.0	585.4	63.8	829.2
Pullinque			62.0			62.0
Chilgener	4.0	22.2	31.8	33.8		91.8
Pilmaiquen		41.1				41.1
Integrated						
Edelmag				4.8	0.1	4.9
Total	**16.4**	**124.3**	**393.0**	**624.9**	**77.9**	**1,236.5**

Source: The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

Key findings

Electricity sector

- Between 1988 and 2000 electricity generation grew from 16,914 GWh to 39,142 GWh, and installed capacity rose from 4,016 MW to 10,045 MW
- Labor productivity in the privatised generation companies has improved considerably
  - In ENDESA, the largest generator, power generated per worker rose from 2.2 GWh in 1989 to 18.1 GWh in 2001
- Labor productivity in electricity distribution also grew substantially after privatisation
  - Chilectra, the largest distributor, has more than doubled its annual sales of electricity since privatisation, from 3,612 GWh in 1987 to 9,253 GWh in 2001
  - Chilectra's customer base has grown from 973,000 to 1,289,000 while the number of workers fell from 2,587 to 722 and energy losses fell from 19% to 5.4% in the same period
- There has been a clear downward trend in energy prices since generating firms were privatised.
  - In real dollars, the drop is approximately 33% in the central electricity market and 73% for the northern market

Source: The Effects of Privatisation on Firms and on Social Welfare: The Chilean Case (2003, Fischer, Gutierrez & Serra)

5.5. Recent developments

In 2011 the Chilean government sold its residual ownership stakes in three water and sewage companies to help fund reconstruction efforts.

- A stake of 29.98% in the water utility Aguas Andinas SA listed on the Chilean stock exchange was sold to new investors via a 2PO raising for US$984 million
- Stakes in the water utilities Essbio SA (24.4%) and Esval SA (38.4%) were sold via a direct sale to the Ontario Teachers' Pension Plan, raising about US$550 million; and
- A plan to sell a 45.5% stake in the water utility Essal (expected raise c.US$100m) was postponed in late 2011 due to market conditions

Section 6

Ireland

Ireland

Key takeaways

i. In Ireland, privatisation occurred with the objective of improving the performance of SOEs

ii. Assets sold have been derived from a number of different sectors. The IPO of Eircom, the Irish national telecommunications firm provided 75% of the total proceeds

iii. Irish governments have used both direct sales and public share offerings as the primary privatisation methods. Direct sales have been generally used for smaller assets while public share offerings have been used for the largest entities

iv. Irish privatisations have generally been perceived as positive with improved service delivery and productivity resulting from a change to private ownership

v. A recent expert panel has recommended some remaining state assets could be partially privatised but that sales should be conducted in a prudent manner

6.1. Introduction

Irish privatisations began in 1991 following the gradual deregulation of the Irish economy. It was one of many policies designed to move the country away from a closed economy and towards the model of a small open economy with the emphasis on competitiveness within the EU and a wider global economy. The Irish approach to privatisation has been one of caution - compared to the UK it was slower and fewer assets were sold. Of the various reasons put forward in support of privatisation, the goal of improving the performance of SOEs has been most prominent[6]. Successive Irish governments have been unwilling to privatise 'strategic' activities such as water and electricity networks, gas pipelines and seaports.

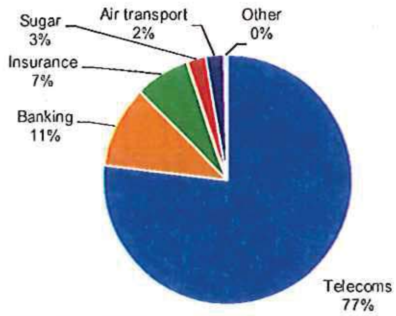
Recently, as a result of the bailout received from the European Financial Stability Fund (EFSF), Ireland is likely to begin a new privatisation programme. A comprehensive review[7] has been undertaken and decisions will soon be made about timing and sequencing of future assets sales.

6.2. What assets have been sold?

The majority of the entities sold operated in competitive markets. They represented the most readily 'saleable' assets that the government had available at the time. Privatised entities have come from a number of different industry sectors. In terms of proceeds the telecommunications sector and more specifically the Eircom transaction make up over 75% of total privatisation proceeds. Total privatisation proceeds since 1991 have totalled €8,329m.

[6] Donal Palcic and Eoin Reeves
[7] Report of the Review Group on State Assets and Liabilities (April 2011)

Privatisation proceeds by sector

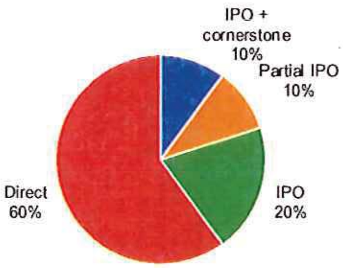


Source: Privatisation and Productivity Performance in Ireland (2007, Palcic & Reeves)

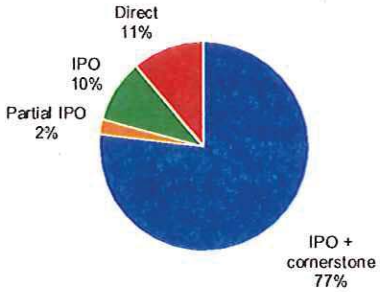
6.3. What sale methods were used?

Irish governments have used both direct sales and public share offerings as the primary privatisation methods. Direct sales have been typically used for smaller assets while public share offerings have been used for the largest entities. The Eircom transaction was undertaken as an IPO with a cornerstone shareholding sold before the IPO. Ireland has also undertaken one partial IPO (Aer Lingus) where the government has retained a stake (i.e. not part of announced tranched sell-down process).

Privatisation methods by volume



Privatisation methods by value



Source: Privatisation and Productivity Performance in Ireland (2007, Palcic & Reeves)

Privatisation methods by transaction

Company	Date	Proceeds (€m)	Method of sale
Greencore	IPO in April 1991	211	IPO
Irish Life	IPO in July 1991	602	IPO
B&I	1992	11	Direct Sale
Irish Steel	1994	-	Direct sale
Eircom	IPO in July 1999	6,340	IPO and cornerstone
ICC Bank	Jan 2001	323	Direct Sale
TSB Bank	April 2001	408	Direct Sale
INPC	May 2001	20	Direct Sale
ACC Bank	December 2001	154	Direct Sale
Aer Lingus	September 2006	200	Partial IPO

Source: Privatisation and Productivity Performance in Ireland (2007, Palcic & Reeves)

6.4. Has privatisation been successful?

The leading piece of research into Irish privatisation was conducted by Palcic and Reeves in 2007.

Privatisation and Productivity Performance in Ireland (2007, Palcic & Reeves)

This paper presents an analysis of privatisation in Ireland and how productivity of individual firms has been affected by the process of privatisation. The analysis looks at performance prior to and after privatisation.

Key findings

Operational efficiency	– In general, with the exception of the two loss-making firms, B&I Line and Irish Steel, the pre-privatisation period for the companies examined was one of improved performance in terms of labour productivity and profitability
	  – The key underlying reason for improved performance in the non-financial public enterprises was the implementation of significant rationalisation programmes as the companies restructured their businesses along more commercial lines
	– The post-privatisation evidence on performance that is available is largely disappointing, especially in the case of Eircom
	  – Both Eircom and Greencore were dominant in their markets at the time of sale, Eircom enjoyed an approximate 80 per cent share of the fixed-line market while holding the larger share of the mobile market duopoly and Greencore held control of the Irish EU sugar quota after divestiture
	  – The post-privatisation record of both companies suggests that product market competition is a hugely important determinant of enterprise performance
	  – In the case of Irish Life, pre-privatisation improvements were sustained following its divestiture in 1991 the company's share price performed well, never falling below its IPO price level after 1993 and increasing significantly in the period prior to the company's merger with Irish Permanent in 1999

Competitive market structure	– The cases of Greencore and especially Eircom highlight the importance of market competition as a driver of efficiency gains
	– In this respect the difference between one-off and ongoing efficiency gains is an important point to note
	  – The improved performance in the years before and after privatisation were largely one-off efficiency gains resulting from restructuring, while ongoing efficiency gains depend on factors such as ongoing investment in research and development and improved processes and management
	  – The post-privatisation experience at Eircom creates doubt as to whether privatisation always creates ongoing efficiency gains, the company implemented significant cuts in capital expenditure with Ireland consequently ranking close to the bottom of European rankings of broadband penetration

Source: Privatisation and Productivity Performance in Ireland (2007, Palcic & Reeves)

Palcic and Reeves have concluded that Irish privatisations have generally been perceived as positive with improved service delivery and productivity resulting from a change to private ownership. In particular, they noted that the most significant gains in performance and productivity often occurred as firms were being prepared for privatisation and gains were more modest after privatisation.

Eircom's demerger of the mobile division Eircell (the company's most profitable division) and takeover two years after its IPO (at a 30% discount to list price), was not a positive experience for investors. Eircom was subsequently relisted and then taken private again. According to Palcic and Reeves, although profitability improved post privatisation, this was mainly due to massive cuts in capital expenditure and a large amount of labour shedding, while service delivery suffered.

Privatisation in Ireland (2003, Barrett)

This paper provides a chronology of Ireland's economic development and the part that privatisation has played.

Key findings

Telecommunications	– Despite its operational issues the privatisation of Eircom did result in reduced consumer prices – The Culleton Report (1992) reported that "telecom revenue in Ireland- at 2.7% of GDP- was by far the highest of any EC country in 1989, with most other Member States having revenue in the range of 1.3 to 1.8% of GDP – The OECD found in August 2000 that "Ireland's international charges are less than half of the OECD average both for business and residential calls in USD/PPP", in a decade Ireland had improved from above average charges to half of the OECD average
Public perception	– Taxpayers have gained relatively small receipts from privatisation receipts but support transfer to the private sector in order to improve efficiency – State ownership was associated in the public mind with heavy subsidisation, requests for free capital, poor service and regulatory capture. The special feature of the Irish case has been the replacement of Irish nationalism and protectionism by support for the EU single market and for global free trade

Source: Privatisation in Ireland (2003, Barrett)

6.5. Recent developments

Ireland suffered severe financial impacts during the GFC, partly because of its comparatively large banking sector and banks' exposure to the domestic property market. Insolvent banks were nationalised, so the level of government debt rose sharply. For this reason, Ireland had to seek aid from the EFSF bailout fund and in return commit to restructure its banking sector and lower its budget deficit.

As a result of this crisis, the government set up an expert group in 2010 to analyse the country's assets, the Review Group on State Assets and Liabilities (the 'Group') to advise on how commercial state assets can be better deployed or disposed of to support economic recovery. In April 2011, the Group tabled its recommendations for better regulation and privatisation of public-sector activities. The report analysed 16 state-owned companies of which it recommended the majority could be at least partially privatised, recognising any programme of sales should balance the longer term strategic needs of the state with the short-term urgent demands for cash, doing so in a prudent manner.

Set against the April 2011 recommendations, the Irish government's stated plans seem more modest – at least for now. It has, for example, announced the sale of a minority stake in the Electricity Supply Board (ESB). It also indicated the possible sale of its remaining stake of just over 25% in Aer Lingus.