THE THEORY AND PRACTICE OF PRIVATISATION

(Considerations for Ireland)

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M B S, 1992

THIS THESIS IS BASED ON THE CANDIDATE'S OWN WORK AND HAS NOT PREVIOUSLY FORMED A PART OR A WHOLE OF A SUBMISSION FOR A DEGREE AT ANY ACADEMIC INSTUTUTION OR EQUIVALENT THEREOF.

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ABSTRACT

Privatisation has become an important political and economic tool. It has been applied worldwide to assist economic growth, to lessen national debts and to free competitive forces. This study examines the theory and application of privatisation. Part One studies the theoretical background. The first chapter explores the arguments for and against its use. The debate on privatisation is largely inconclusive. Its merits and demerits often cancel each other. In Chapter One privatisation is seen as a versatile economic and political policy but its use depends wholly on the circumstances of each case. A privatisation strategy based on ideology will achieve few of its goals.

The varied forms of privatisation are examined in Chapter Two. It is shown that privatisation is far more than mere divestiture. An expansion of joint ventures, franchising, contracting and other deregulatory tactics are all part of the set of privatisation policies.

Britain's privatisation programme is the main focus of Part Two and is the sole subject of Chapter Three. This examines the background to and the process of privatisation in the UK. Many case studies are explored. The success of the British programme is assessed and lessons for Ireland are recorded.

Privatisation experiments have been global. Chapter Four explores the practice of privatisation in Europe, North America and the rest of the world. From the early privatisations of Chile to the recent divestitures of Eastern Europe, this chapter reveals the many reasons for and approaches to privatisation in the First, Second and Third Worlds.

Chapter Five is the focal chapter of this study. Having explored the theory and practice of privatisation throughout the world, strategies are considered for an Irish privatisation programme. The establishment to Ireland's State sector and the prospects of future changes, including privatisation, are assessed.

Chapter Six is a brief summary of the issues raised.

THE THEORY AND PRACTICE OF PRIVATISATION

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PART ONE

THE THEORY OF PRIVATISATION

CHAPTER ONE

THE PRIVATISATION DEBATE

I THE ARGUMENT

Views on the merits and demerits of State ownership are usually based on views on the role, size and importance of the State. A typical debate, say, on the appropriate ownership and operation of a national airline explores less the economic issues than the political.

Proponents of the privatisation of the national airline may point to the excessive involvement of the State and to the need for less political interference in all of our lives. They may argue that private ownership will bring better worker and managerial efficiency and a greater choice to the consumer. This may lead to greater economic growth and improved welfare for all.

Opponents of privatisation fear a deterioration of services and a fall in employment. They argue that without State intervention the gap between the rich and the poor becomes greater. The government should not renege on its central role of providing for all. The political aspects of the airline ownership can overshadow the economic realities.

It is essential that an Irish government, in its consideration of a particular privatisation, separate the political from the social and economic issues. That is, decisions should be based solely on the real social and private benefits and the expected costs. This thesis reveals that privatisation, though sometimes worthwhile, may not succeed if its application is based on ideology and dogma. Instead, privatisation has developed into a useful strategy that can help in the process of deregulation. Its application must be selective and be based on individual circumstances.

Privatisation has developed, largely, as a political, not an economic tool. The debate on its advantages and disadvantages remains unfairly biased by the debaters' political views. This study attempts to divorce the political from the economic issues and to consider both. The study reveals that privatisation is a hugely diverse and varied policy. Often misrepresented and misunderstood, privatisation is neither a quick nor an easy remedy.

Privatisation, a relatively new word, has attracted much debate. The Oxford English Dictionary dates the origin of this word back to 1960 and defines it as, "The policy or process of making private as opposed to public" (O.E.D., Vol XII, p521). The Canadian State of Saskatchewan prefers the term, "Public Participation" (Walker G, 1988). Nicolas Ridley MP, inspirational in many of the early Thatcher privatisations, used the term "real public ownership", the emphasis on real (Griffiths and Wall, 1989, p160). The

Pocket Economist (1987) begins its definition of privatisation thus, "Ugly antonym of another ugly -ation: nationalisation". Privatisation is often associated with such terms as liberalisation and deregulation. It is occasionally used as another word for divestiture or as synonymous to 'closure'.

Whatever term is used and whatever your point of view, privatisation is an 'action word'. It involves the transfer, wholly or partly, of the ownership of a company from government hands to the hands of private individuals or institutions. The important part of this definition is the phrase 'wholly or partly'. Privatisation is commonly and erroneously interpreted as meaning the opposite to 'nationalisation'. Privatisation suggests that the government is walking away from the control and operation of a public enterprise. But privatisation can be much more or much less than this. In some cases privatisation results in an increase in government activity, particularly in the area of regulation and consumer protection. On the other hand a successful privatisation may involve only a partial withdrawal of government investment and influence. The initial sale of British Telecom in 1984, for example, amounted to no more than a 51% sale of the company. The government continued to hold a 'special' share, allowing it to veto some decisions and in effect to maintain a large influence over the direction of company policy. The part-privatisations of Greencore and Irish Life in 1991 alllowed the Irish State to retain majority shareholding, at least for a while.

Other forms of privatisation include contracting-out different elements of a service. The contractor is paid by the government who, in turn, receives tax revenue from the people. Privatisation may involve the franchising of a service. In this case the public pay directly for the service. The government charges a fee for the franchise. Privatisation may mean the provision of grants to aid producers of a service or of vouchers to aid consumers. The government can privatise by increasing the number of joint ventures between State-owned enterprises and the private sector.

These methods of privatisation and combinations of these methods are explored in Chapter Two. The chapter shows that privatisation is a collective word for a wide variety of policies. Opportunities for privatisation in Ireland lie beyond mere divestiture, although it, too, has a role.

It is necessary to examine the arguments for and against privatisation. In many cases an argument in favour of privatisation is challenged directly by an antithetical argument against. In some cases the arguments are theoretical or judgemental, others are concrete and factual.

Whether privatisation should proceed depends on political aspirations and on the economic conditions in individual cases. A large variety of actual cases are explored in Part Two. From these examples, privatisation is shown to be of limited benefit when used alone. Its value is only realised when it is part of a deregulation process designed to widen competition and consumer choice. At the same time care must be taken that the pursuit of improved efficiency is not undertaken at the expense of comsumer rights and environment protection. This thesis reports many cases where privatisation has lead to monopoly powers passing from public to private hands, almost undiluted. There are also many cases where the consumer and the tax-payer lose out through the process of the privatisation. The consumer can lose through price increases that may follow privatisation. The tax-payer suffers when the State asset is sold cheaply.

II THE PROPOSITION

The case for privatisation is proposed by a wide range of thinkers and politicians. In France the centre-right government of the mid-1980s firmly believed in the sale of State enterprises. The left-of-centre / liberal German coalition government and the socialist governments of Australia and New Zealand are also determined supporters. In Britain, the argument has been along party-political lines. The right of the political spectrum are greater supporters of privatisation. Those on the far right hope to privatise health, coal, rail, and education. Those around the centre believe that selective privatisation is a good thing. Those on the left plan to renationalise or, at least, restore majority public ownership in the main utilities.

Privatisation is associated with right-wing thinkers and with 'The New Right'in particular. In Britain, views of the New Right are voiced by the Adam Smith Institute, The Institute of Economic Affairs and The Economic League. They favour the minimisation of State interference. They point to the economic catastrophes of the 1970s as proof that government intervention does not aid economic growth. Any alternatives to pure market forces are intolerable and counter-productive. They reject the idea of an omniscient and omnipotent State that exists to ensure economic equality (Gamble, 1989). They dismiss the idea that the government should provide merit goods such as education and health. By lowering State subvention, taxes can be reduced thereby increasing peoples purchasing power and, subsequently, their choices. State presence is detrimental in the decision-making process and violates individual rights. The New Right specifically reject State intervention in and control of industry. Where possible the State should withdraw from the hub of the economy. The government's role should be no more than that of a 'helmsman' (the original meaning of the word, government). Divestiture is an essential step in reducing the size of the State and in increasing peoples' freedom.

Not all proponents of privatisation belong to the New Right. Support for the withdrawal of State control of industry comes from many socialists in Europe, Australasia and elsewhere. All agree that privatisation has a number of advantages.

Of interest to an Irish government is the idea that the Public Sector Borrowing Requirement (PSBR) will fall as a result of privatisation. The sale of heavily subsidised enterprises reduces government spending and borrowing (assuming all subsidies to the privatised firm are less than those allocated to its public predecessor). Revenue earned from the sale is counted as negative government spending and again reduces the PSBR for the year of sale. Britain's PSBR fell from a stg£12,519 million requirement in 1982 to a stg£11,680 million excess of funds in 1988 (Kompass, 1990). This was partly due to the sale of State companies, the sale of local authority houses and to other retrenchment schemes whereby the government withdrew active involvement.

Privatisation means less government interference. The Economies of most developed countries are still showing the effects of post-war, government led, expansionist policies based on Keynesian demand management economics. This school of thought asserts that a fully employed economy is unlikely to come about spontaneously. It is the government's role to inflate or deflate the economy so that full employment of the factors of production is reached and maintained. The State must be ready to intervene where the optimum combination of factors is not being attained. This direct approach served governments well in the 1950s and 1960s. Government action remains appropriate so long as it is swift and correct. But governments got it wrong too often in the 1970s. In Ireland, 'demand management' has left its legacy, 'debt management'. Continual high taxation and crippling debt repayments reduced real incomes and stunted growth. A vicious circle emerged.

Ireland learned valuable lessons from the excesses of the 1970s. In the 1980s it quickly became clear that the government must decrease its spending. A campaign of spending cuts was pursued for the rest of the decade. Instead, a privatisation policy could have been implemented. This might have reduced the need for borrowing and have provided revenue for servicing the debt. It is unlikely, however, that a privatisation programme alone would have been sufficient to halt the acceleration of government expenditure. Fiscal rectitude would still have been necessary.

Less government interference in the management of an enterprise is another common goal of privatisation. A management that is answerable to consumers and shareholders is more efficient than one answerable only to a minister. A management that can reach its own decisions based on market research and not on the constraints of the PSBR is more efficient. A management that is not seen as a political puppet but as a shrewd risk-taker is more efficient. A management with a direct stake in the success of the company and whose remuneration is related to the company's performance, is more efficient. The hierarchal structure of many State enterprises can cause inefficiency. It is only by replacing State intervention with the profit motive that market economies perform properly. When this occurs allocative efficiency can be realised. This is possible only when all x-inefficiency is eliminated. Leibenstein defined x-inefficiency as the difference between maximum effectiveness of the utilization of inputs and actual utilisation (Heald, 1983, p89). Where there is no difference, x-inefficiency has been eliminated. McDowell refers to x-inefficiency as 'slack' in the system. This is caused by inappropriate input proportions, underutilised resources or unrequited demands (McDowell, 1987). Privatisation can eliminate this 'slack' because the management, acting solely on a commercial basis and not constrained by political or social obligations, can employ the correct proportion of inputs and resources to satisfy demand.

A privatisation programme may be part of the general deregulation of an industry. The aim is to restore vigor and energy to the market-place. That is, it allows the market to reach equilibrium, spontaneously. "A monopoly", writes Neuberger, "is a licence to snooze" (Neuberger, 1987, p87). The break up of one revives hopes of real and pure competition. Economics reveals that maximum profit (traditionally accepted as the general goal) is attainable at a lower price and a lower cost in a highly competitive market compared to a monopolistic one. Allowing more competition and minimising government control will increase efficiency, profits and growth. Allowing a number of profit-seeking companies to compete in the market-place is preferable to sustaining an inefficient public monopoly unless that monopoly is proven to be a 'natural' one. The pursuit of maximum profit is likely to be more efficient than the appeasement of a government minister.

There are several other arguments in favour of privatisation. Ferguson challenges the 'natural' monopoly argument in favour of State ownership (Ferguson, 1988, p151). Where economies of scale are inexhaustible, a single monopoly is the most efficient arrangement. That form of monopoly has been traditionally State-owned or heavily State regulated. Ferguson says that the State control hinders long-term competition from new products and processes. In the long run, efficiency, competition, the industry and the consumer all suffer from the State control. The fear that a privately owned natural monopoly will exploit supernormal profits is challenged by the contestibility theory. That argues that as long as the market is penetrable by other firms, the dominant firm will resist temptation to earn supernormal profits so as not to draw attention upon itself (Baulmol, Willig, Panzor, 1982).

Privatisation can bring greater freedom to people's lives. Proponents of privatisation often refer to 'liberalisation'. They seek to liberalise not only the markets, but also consumer choice. By introducing perfect contestibility for contracts or franchises, liberalisation can encourage efficiency and may be a test for an industry's suitability for full deregulation and the complete withdrwal of government intervention. Privatisation creates choice and, in a sense, a greater democracy. Through privatisation and deregulation, alternative goods and services are produced, providing a wider choice and, more importantly, a greater freedom to choose. According to Goodwin (1983), reducing the welfare State and lowering taxes broadens people's freedom to pursue their own preferences, to display their own diverse tastes, to dispose property as they please and to act upon their own moral principles. McDowell asserts that the liberalisation that has occured in Ireland in the financial, radio and bus transport sectors has resulted in increased efficiency and improved services, just as the contestability theory suggests (McDowell, 1987).

Privatisation and liberalisation are separate policies. Privatisation, itself is not liberalising. The merits of privatisation can only be realised if its legislation is accompanied by complementary legislation for the liberalisation of competition.

Privatisation ought not be a barrier to the government's assumed role to provide essential services. The government can 'provide' services but it need not necessarily 'produce' them. Forms of privatisation include strategies to allow others to 'produce' the goods and services. It remains the government's role to see that these are 'provided'. The production of the goods, once separated from their provision, can then be privatised and opened to competition. The government's resources and concerns can focus on specific services whose production remain within the public sector. The range of privatisation options available to the government are examined in Chaper Two.

Privatisation may bring an end to the public's mistrust of large public corporations. The tough laws of the market-place and the watchful gaze of shareholders and consumers make it difficult, in theory, for private management to engage in corrupt activities. In Ireland, the series of financial scandals of 1991 further undermined the public's confidence in the business ethics of large enterprises. Public ownership has not protected corporations from the criminal exploits evident in the private sector. On the contrary, their public ownership may have helped them to connive and deceive. The taxpaying public is more outraged when these offences occur in the public sector because it is their money which is being abused.

Steel and Heald point to another likely benefit of privatisation. They argue (Steal and Heald, 1985, Ch3) that employee trade unions in a private company understand that excessive pay claims may lead the company to bankruptcy. They are, then, more reasonable negotiators than public employee trade unions who are not usually confronted with the threat of closure. The concessions given to the public sector unions as a result of the renegotiation of the Programme of Economic and Social Progress (PESP), the threatened strike in the ESB in 1991 and the 1992 strike in An Post have highlighted the argument that public sector union power should be curtailed. Industrial relations in the public sector are particularly unstable because a monopsonist employer (the government) often confront a monopolist union. Heald cites this as the reason for Britain's public sector accounting for 82% of working days lost due to industrial unrest in 1980 (Heald, 1983, p212).

III THE OPPOSITION

Privatisation is opposed for many reasons and by people with varied political backrounds. In Britain, the opponents are the opposition Labour Party, trade unions, socialist economists, social democrats and left-of-centre pressure groups. Just as supporters of privatisation argue about how far privatisation should proceed, the opposition quarrel over the degree of privatisation which is acceptable. For some, any reneging on the State's duties is wrong. For many, the sale of public enterprises is contrary to their view of the welfare State and of the role of government. Others fear it can lead to an unacceptable imbalance within society. Assets accumulated with taxpayers' money and the State's initiative are carelessly transferred to private ownership. They fear that power will gather around the already powerful.

One way to examine the case against privatisation is to list the arguments used in favour of nationalisation. Like privatisation, nationalisation has been inspired by politics. Private companies and industries are nationalised often for political reasons. In the 1930s, Herbert Morrisson developed the framework whereby companies would be State controlled and financed but run autonomously on a day to day basis. He developed the concept of a public corporation which, freed from commercial pressures, can concentrate on the nationwide provision of merit goods and essential public services.

The British Labour Party is committed to maintaining a large degree of direct government involvement in industry and commerce. It is a commitment that has polarised the party from the British Conservative Party in the recent past. This same commitment caused great changes during the 1940s and the 1950s. The State control of industry in that period fostered tremendous economic growth and reconstruction.

The nationalisation of industries was occasionally part of a more general State industrial policy. In Ireland, key industries such as electricity, milled peat production, airlines and telecommunications were either nationalised or dominated by newly formed State companies. In this way, the State helped to direct and control industrial policy. In other cases, though, nationalisation was just a policy to rescue crippled companies.

Nationalisation was also seen as a method of controlling the profits of large companies. Where huge economic rents are earned by mostly monopolistic firms, the whole nation, through nationalisation, should be allowed to benefit. This argument has resurfaced in a different light since the announcement of huge profits by the privatised British Telecom (BT), British Gas (BG) and the UK Water Companies. Controls on these profits have been sought by political and consumer groups.

When increasing returns to scale are thought to be limitless, a 'natural' monopoly may exist. Minimum costs for the industry is attainable only when there is one firm. In most countries the government has preferred to own and control that monopoly. These monopolies are most efficient when left as monopolies and it is in the public's interest that they be State-owned. The State monopoly can be instructed to set prices at the minimum of the long-run average cost curve whereas a private monopoly would seek maximum profits and exploit a large economic rent.

Another argument in favour of State ownership and in opposition to privatisation is that only the State responsibly considers the social costs and benefits of an investment proposal. A private company, on the other hand, would consider only the financial and commercial aspects of the proposal. The private monopoly would fail to supply adequate services to remote areas. In short, a free market would not be sure to provide essential services.

Nationalisation may be favoured where conflicts arise between commercial and public interests. A State-run bus company may continue to service those remote areas which a commercial business would consider invalid. State employees would be paid fairly and well. Profits from State enterprises may be redistributed throughout the economy. Tax revenue can be redirected to those areas most in need. This can lead to an equitable distribution of income and opportunities. Nationalised and State-created enterprises are there to serve the needs of all the people, equitably. To sell these in part or in whole is to deny essential services to all people regardless of their purchasing power. In Britain, the government occasionally used a 'least subsidy' tender system. Private firms, for example, were invited to provide a quality bus service to remote areas in return for a small subsidy. The most innovative, efficient firms produced the loss making service for the smallest subsidy (Pirie, 1988).

During the 1970s State bodies were encouraged to do better than break even. Prices were set to equal long-run marginal costs. By the end of the 1970s most British nationalised industries were free to set their own prices so that financial targets would be met. It was hoped that the companies would continue to supply all services whilst achieving a reasonable return on capital employed.

A different argument for direct State intervention is the occasional need to control competition (Breyer, 1990). A ballooning of competition can lead to price wars resulting in many bankruptcies and much hardship. From this chaos, a dangerous duopoly may emerge. The industry's long-run competition and efficiency may suffer. When this is threatened, the government should intervene through regulation and, perhaps, nationalisation. Privatisation, on the other hand, may lessen the government's control of the situation.

These arguments in favour of nationalisation are not sufficient opposition to privatisation. Many of the once favoured arguments in support of nationalisation have lost their relevance. It is no longer true to say, for example, that natural monopolies belong in State control because they are beyond the monetary scope of private enterprise. Private, transnational corporations possess capital that can exceed the funds available to small developing nations. National governments, constrained by fiscal, monetary and exchange rate policies and by intra-governmental agreements, are not free to intervene swifty and correctly in industry. The private sector has the know-how and the resources for such intervention.

An alternative approach to opposing privatisation is to challenge the arguments of its supporters. Whitfield examines what he calls the 'myths' presented by the British Conservative Party during the 1980s (Whitfield, 1983, Ch3). The first myth is that privatisation creates a "company owning democracy" (p28). The sale of a public company directly to the public or to management is said to increase 'democracy'. This is a myth because the share ownership does not remain in the hands of the general public for very long. The number of shareholders in British Aerospace fell from

157,829 in Feb 1981 to 27,175, a year later. The number of small shareholders (less than 100 shares) fell from over 40,000 to under 4,000 in the same period. The number of investors with a millon shares or more increased from one to thirteen (Whitfield, 1983, p29). On the first day of trading (25 Feb, 1982) in the shares of Amersham International there were 65,000 shareholders but by June of that year the number of shareholders had fallen to 8,600 (Mayer and Meadowcroft, 1985).

The attraction of privatisation to small investors is not democracy but quick profits. Besides, what is democratic about a small number of people buying a public company that, by definition, had previously been owned by everyone? Privatisation is wrong because it allows the assets of the State to be taken over at a low price by a small number of affluent investors.

A second myth is that privatisation increases one's freedom. This is not so if one becomes unemployed as a result of privatisation. The revenue from British privatisations may have been used to boost the State securities thereby, in a sense, threatening individual freedom. Friedman's and Van Hayek's arguments in favour of freedom are challenged by Goodwin (1983). Privatisation cannot result in a general increase in freedom because freedom is a constant-sum game. That is, freedom given to one is taken from that same one or another. For example, the freedom to choose that may result from privatisation and deregulation (through tax cuts and dividends) may be fully negated by the loss in purchasing power as prices rise.

A common argument in support of privatisation is that it creates efficiency. Yet the cost of privatisation is itself colossal. The UK Comptroller and Auditor General estimated that the sale of British Telecom (1984) cost £263 million (Newman, 1986, p171). Most public share flotations issue shares at knock down prices in order to ensure their success. The share price of Rolls Royce rose by 73% on the first day of trading (May 20, 1987). In France the flotation issue of the *St.Gobain* glass-making group was 14 times over-subscribed (Fraser, 1988, p119). The British Telecom issue was hugely over-subscribed with £16,575 million chasing the £3,916 million worth of shares on offer (Newman, 1986, p165). Critics also point to the substantial and costly grooming of a public enterprise prior to its sale. Refering to the imminent sale of British Telecom, The Economist (6 Oct, 1984, p85) stated that, "The government is rigging things as far as it dares in BT's favour".

British Airways is a good example of this rigging. The £545 million loss suffered by BA in 1981/1982 was a highly inflated figure designed to enhance the apparent improvement of the company prior to the 1987 sale. The 1981/1982 figures included the full cost (£199 million) of the job rationalisation plan which reduced employee numbers from 58,000 employees in 1979 to 35,000 in 1983. The year's accounts also included the £208 million cost of decreasing the aircraft's depreciation period from sixteen to ten years (Whitfield, 1983, p37). The government also wrote off most of the companies £1 billion debt prior to privatisation. British Airways was eventually sold for just £892 million (Rickard, 1988).

Privatisation is not, itself, a stimulus for improved efficiency. The true stimulus is competition for and within the industry. Improvements in productivity, costs and return on capital is attainable while the company remains publicly owned. This study shows that privatisation alone does not necessarily improve a firm's efficiency unless combined with improved competition in the industry. Economics explains efficiency as the correct combination of inputs to obtain optimum output at minimum cost. This is more likely to be achieved in markets where competition, not monopoly, exits. By breaking up monopolies, privatisation may promote efficiency. In reality, monopolies are seldom broken up. Governments are interested in maximizing revenue from a successful flotation of a State monopoly. Since monopolies sell best if left as monopolies, there is a reluctance to break them up for fear of discouraging investors. By keeping the monopoly intact governments may increase their revenue.

But the now private monopoly is not necessarily more efficient than the public one. It is questionable that management, when freed of the constraints of the PSBR and of the qualms of ministers, become more efficient, urged on by the pursuit of maximum profit.

De Fraja suggests that the efficiency objective of privatisation may be counter-productive (De Fraja, 1991). Privatisation, he says, may result in the improved efficiency of the firm but may cause a fall in the efficiency of the industry. This is because as the firm cuts output to improve efficiency, the competitive pressures on the industry as a whole is relaxed and inefficiency may develop throughout.

The assumption that profit maximisation is the primary goal of management needs to be challenged. Shipley found that only 5.2% of firms surveyed (based on a random selection of 728 British firms listed in Kompass) saw profit maximisation as the sole objective (Shipley, 1981). Maximisation of profits is only one goal in a set. Only one third of the respondents cite profit requirements as the principal objective in the goal set and nearly one eighth do not include a profit target in their set at all (Shipley, 1981). Baumol's theory of Sales Maximisation suggest that a firm will try to maximize sales provided that some acceptable level of profit is being attained. Beyond a reasonable profit an "additional profit is not worth the loss in sales" (Baumol, 1958). Marris argued that growth was the main motivator in management performance. It is the idea of performing 'better' that encourages efficiency. Simon's idea of 'satisficing' says that managers do not really know what level of sales or profits they are seeking. They only wish to reach satisfactory levels. However, as these levels are reached, aspirations increase (Griffiths and Wall, 1989, Ch3).

All of these arguments suggest that passing the ownership of a company from government hands to private hands does not imply greater efficiency or greater maximisation of profit. The performance of a public enterprise itself can improve without selling it to private investors. Greater motivation and incentives can be achieved within a public enterprise. Griffiths and Wall (1989, p141) produce data showing that the performance of nationalised industries improved by greater than the average for all manufacturing and more than twice the average of the whole economy during the years 1979/'80 to 1986/'87. The authors conclude that "this is all the more remarkable because this set of industries is what is left after privatisation of the best performers".

There are other criticisms of privatisation. It is clear that the reduction in PSBR that Ireland may enjoy by embarking on a privatisation programme will be short lived.

Ireland will run out of enterprises to sell. One must also consider the public sector profits foregone as a result of privatisation. Although the PSBR may fall while revenue from the sales is received, the net effect on public finances may be nil. By receiving payment for the privatised firm, the government foregoes the income stream of future profits. The discounted present value of the profits forgone should, in theory, equal the selling price. The net result, though, remains a loss to the government because of the high costs of the sale. For these reasons, the Irish government should not view privatisation as a solution to the national debt problem. It is likely that only the profit-making, cost-effective State bodies will be sold leaving the loss-making enterprise as a continual burden on tax payers.

A series of large privatisations may lead to a form of 'crowding out'. That is, small investors will buy shares using disposable incomes that would otherwise have been saved. The financial institutions are, therefore, deprived of funds because of the fall in savings and because those loanable funds that are available are being invested in the privatisation. This may push up interest rates, crowding out legitimate investment in new capital. The investment that occurs is only in the non-productive transfer of ownership. Furthermore, the high interest rates may push up exchange rates and damage exports.

National security and sovereignty may be other concerns of a privatisation programme. The sale of State bodies could be detrimental to the nation as a whole. It may be undesirable for our national airline or our power industries to be owned by non-nationals. Guarantees that a 'special' share will be held by the government are ill-favoured following the purchase of the privatised Jaguar (British) by Ford (American). Many socialist governments of the post-war period saw State ownership of key industries as vital to the maintenance of peace. By keeping the control and ownership of critical sectors of the economy in government hands, greater equality of opportunity and welfare, and greater security of sovereignty would be achieved. The government ought to be involved in the production of key goods and services. In particular, the government should produce the key resources for industry to guard against scarcity and price shocks.

IV CONCLUSION

Privatisation was a keyword of the 1980s. It was mainly associated with the Conservative Governments of Great Britain. Its effects have been found elsewhere, nowhere more so than British Columbia. There the government gathered almost all the State bodies into one basket and sold the lot. To do this they created the British Columbia Resources Investment Corporation (BRIC). By buying shares in that corporation people were, in effect, becoming shareholders in each and all of the public enterprises. The offer included a gift of five shares of BRIC to all residents of British Columbia. The remaining shares were sold at $6 each. 170,000 British Columbians bought shares bringing the value of the issue to $487.5 million. This extraordinary flotation took place in 1979, before privatisation emerged as an international political issue.

Most other countries were more hesitant in their approach to privatisation. The experimentation with privatisation in countries like Britain, France, Japan and the USA is explored in Chapters Three and Four. Privatisation, though, has become worldwide. By 1988 the USA had 23,000 instances of privatisation. Canada now has a Minister of State for Privatisation. New Zealand planned (in 1988) to pay off one-third of its $28 billion national debt in five years with privatisation receipts (The Economist, 5 March, 1988). Privatisation is also pursued in many developing countries like, Bangladesh, Chile, Sierre Leone and Nigeria. It is also a key strategy in the restructuring of eastern Europe and of the former USSR.

Evidence that a privatised firm performs better than a public one is patchy. A comparison of municipal (monopolistic) and private (competitive) street maintenance in Southern California showed that the city-operated service was 37% more costly. Paving and road repair was found to be

96% more costly under municipal management than under private. Less absenteeism and a more appropriate ratio of supervisors to workers were cited as possible reasons. Another American study (Walker M, 1988, Ch7) found that a passenger would be six times more likely to get killed travelling on a public bus than on a private one. Public sector bus drivers were being paid twice as much as private drivers. In Chicago private bus services for the disabled are operating at half the cost of similar public services.

Pryke (1982) compared nationalised industries to similar private enterprises in Britain. He compared British Airways to British Caledonian and Sealink to Euro Ferries. He concluded that publicly operated enterprises performed worse than private ones.

Gajerski's study of public and private car insurance in Ontario reveals that the performance of State-owned insurances far outdo the performance of private insurances. The average net increase in premiums for the period 1983-1987 was 20% for public and 58% for private insurers (Gajerski, 1991).

Chapter Three records the effects of privatisation on British firms. There are many examples of huge profits earned by privatised firms. Yet many of these firms were beginning to record large profits before privatisation took place. The case that privatisation itself significantly improves efficiency and profits has yet to be proven.

Heald warns that great difficulty remains in assessing the relative efficiency of the public sector since most studies are based on "flimsy and impressionistic evidence" (Heald, 1983, p309). The multiplicity of constraints and objectives within the public sector makes comparisons difficult. Studies fail to account for the effects of the lower public sector interest rates, of cross-subsidisation and of the discriminatory legislation that tends to work in favour of the public firm. Ferguson suggests that studies often fail to show the relative inefficiencies of public sector firms because the private firms against which they are compared are often heavily regulated by the State. They, too, suffer from the same regulatory disincentives that face the public firm (Ferguson, 1988, p156).

Studies do not reveal that the cause of high profits is the company's public ownership. Nor do studies of companies before and after privatisation show the result of privatisation itself. We have seen how British restructuring of State bodies just prior to privatisation would greatly hinder a proper study. Too few reliable studies have been done. It is not yet possible to measure the total nor long-term effects of privatisation. Such a study would be difficult to create. Highlighting the vastly improved balance sheet of British Airways, for example, would be quite pointless if we ignored the pre-privatisation manipulation of accounts and the human and social cost of labour redundancies. Many of these costs are difficult to determine.

The privatisation process has been excessively expensive. Advertising and promotional campaigns for British privatisations have been elaborate and costly. Underwriting the share issues has been big business and has greatly increased costs. It has not always been successful. When the underwriting guarantee was expected to compensate the British government for the complete failure of the BP sale in 1987, the underwriters refused to pay, claiming that October's Black Monday was freakish and unforeseen. (A settlement between the government and the underwriters was reached eventually.)

Privatisation may be judged as a wasteful, costly sale of the people's assets to the people. Share ownership is meant to lead to a greater democracy but can result in selfishness and greed. Privatisation may be no more than a form of asset-stripping. Public enterprises are sold, broken up into pieces and sold again for a profit, yet net investment in the economy is nil. Fears of redundancy, low pay and exploitation remain. There are fears that the privatised firm will charge any price it chooses. Critics will note that Littlechild's **RPI-X** price formula for the new BT Plc was quickly adjusted to **RPI-X+Y** for some services (see Chapter Three). In Britain privatisation has created a new type of class struggle between wealthy, mobile investors and the unemployed and low paid.

In the many cases explored in this study the economic benefits of privatisation have not been realised. Gains in efficiency and competition have been sacrificed. Privatisation methods other than share issues have been under-utilised. The political objectives of wider share ownership, revenue maximisation and the dismantling of trade union power, have dictated the pattern of the privatisation process.

Privatisation has altered the outlook of public sector managers and employees. No State company and no State service, almost anywhere in the world, is not faced with the threat of privatisation. Complacency is no longer a perceived feature of the public sector. The public, too, have come to rely less on direct State production of goods and services. Privatisation has developed from a radical strategy to a routine, familiar policy.

A solid case in favour of privatisation does not emerge from this thesis. Privatisation is shown to be a useful but limited economic weapon. Privatisation is not a sufficient stimulus to improved efficiency. It is worthwhile only if pursued as one element in a set of deregulatory and pro-competitive strategies. Privatisation alone will do little to improve national finances, consumer choice or efficiency within an industry. Ireland's privatisation programme should not be developed for political or ideological reasons. Instead, the privatisation of an Irish State-owned enterprise should only proceed where the expected economic gains clearly outweigh the total economic and social costs. Such a thing as a privatisation crusade is wholly inappropriate for Ireland.

The remainder of the dissertation further explains the theory and practice of privatisation and develops the case for its limited use in Ireland.

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CHAPTER TWO

TYPES OF PRIVATISATION

I TYPES OF PRIVATISATION

II DEREGULATION AND DIVESTITURE

III TYPES OF GOODS

I TYPES OF PRIVATISATION

Many of the arguments discussed in Chapter One focussed on a narrow definition of privatisation. Privatisation has become largely synonymous with divestiture and share flotations. This chapter explores the many forms of privatisation. Privatisation means some government withdrawal from the production of a good. This withdrawal need not be complete. There are many intermediate stages between government production and private production of services. These stages are examined below.

It is important to distinguish between 'providing' a service and 'producing' that service. Opponents of privatisation believe that a basic role of government is to provide essential goods and services (henceforth 'goods') for all of its people. Privatisation need not be seen as a threat to this role. There are many cases where the government arranges that a good be produced by private firms. The central role of government to provide goods is not compromised although it is private not public firms that are producing these goods. The public is unconcerned whether work such as pavement resurfacing is done by workers privately contracted or publicly employed. As long as the work is done properly, quickly and efficiently, the public, that is, the tax-payer is satisfied.

Having divorced the roles of provider and producer it is necessary to examine possible privatisation arrangements. (Most of the headings that follow are from Savas 1987, Ch 4, although the discussion and the diagrams are my own).

Figure 2.1 below presents the possible arrangements. There are two players, government and private enterprise. Each player has two possible moves, provide and/or produce, and no more than one player can make either move.

```
   FIGURE  2.1                                A  MARKET          A1
---------------------------------                VOLUNTARY       A2
I   private             private      I           SELF SERVICE    A3
I   sector              sector       I           VOUCHER         A4
I   provides     A      produces     I
I                                    I        B  GOVERNMENT
I       B                   D        I            VENDING        B1
I                                    I
I                                    I        C  GOVERNMENT
I   government   C      government   I           SERVICE         C1
I   produces            provides     I           INTER-GOVERNMENT
I                                    I           AGREEMENT       C2
---------------------------------
                                              D  GRANT/SUBSIDY   DI
                                                 FRANCHISING     D2
                                                 CONTRACTING     D3
```

Figure 2.1 ARRANGEMENTS OF THE PROVISION AND PRODUCTION OF GOODS

SET A

Area A in Figure 2.1 represents what neoclassical economics deems to be closest to the optimal position when market failure does not exist. This is the arrangement of the **open market** (A1). Private firms provide and produce the good. The entrepreneur sees an opening in the market and risks a loss in order to gain a profit. If the market is truly free and open this arrangement may lead to a perfectly competitive environment. The private firm is forced into an efficient position producing at minimum cost and charging an optimal price. A1 is an aspiration of privatisation.

If, however, the market-place fails to provide the necessary entrepreneurship, the good may be produced **voluntarily** by charities (A2). Again the service is provided and produced by private, and in this case, altruistic, individuals. When neither the market-place nor a charity are prepared to provide or produce, it is often possible for a private individual to help himself (A3). Washing one's own car in one's drive-way is an example of such **self-service.**

In each of the three arrangements A1 to A3 the government has no role aside from legislation making it possible. (Such deregulatory legislation is often a necessary first step in a privatisation programme.) The **voucher** system (A4) is the result of initial government action. In this arrangement the individuals such as pensioners, are given vouchers which they can use as they wish. They consume goods whose production has been arranged privately. The consumer chooses the private producer and is acting as a normal buyer except he uses government vouchers instead of other forms of money. It is in the private producer's interest to produce an efficient and competitive service. The holder of the voucher can go elsewhere.

The voucher system allows the consumer to exercise his right to choose and to discriminate between goods produced well and those produced poorly. The voucher system is a simple step towards privatisation. Once vouchers are introduced their value can be reduced over time so that the service is more privately financed. Ireland's medical card scheme is a voucher arrangement. The patient's money is his card and he can choose relatively freely in the market-place. (However, that market-place is not as competitive and as open as the ideal.) A pensioner's bus/rail pass would be a voucher system if he/she was allowed to use the card to consume any form of transport. It should also be noted that the medical card and the travel pass are inexhaustible unlike real vouchers. The British government has recently announced plans to transform Youth Employment Training into a voucher system. The idea is that the youth can use the voucher for any course of his/her choice. The US Administration has plans to increase the use of vouchers for the provision of housing and education. The ultimate voucher is cash.

SET B

Subset B of Fig.2.1 presents an apparent oddity. In this arrangement the **government** is the producer of a service that is provided by a private firm. The government receives a fee for producing the service. Such a situation is not uncommon. An example is a private sporting organisation hiring the government police for security and crowd control in its stadia. Similarly, private firms may buy information from government agencies such as the Meterological Office or the Central Statistics Office. This arrangement is not an aim of privatisation. It does not lead to less government but may lead to a more flexible, market orientated government. It is a method of raising revenue and it may be a way of testing how a government agency may succeed in the open market after privatisation.

SET C

Area C of Fig.2.1 is usually the initial target of privatisation. Under this arrangement a public authority provides and produces the good. This is the antithesis of the market system (A1). The supply of electricity by the ESB, the supply of telephone services by Bord Telecom and the maintenance of roads by local councils all belong to this familiar arrangement (C1). Proponents of privatisation oppose this marriage of **government production** and provision of goods. On the other hand the traditional role of government has been to provide certain 'merit' goods for the benefit of all its people. These are goods which the government consider should be available to every citizen, regardless of income.

In the context of this paper a compromising (yet small) step towards privatisation may be an **inter-governmental agreement** (C2). This is possible and common in a federal union where a government supplies services to other states. Examples of this include the sale or sharing of police intelligence among various states. Similarly, one State may allow citizens of another to avail of facilities in that other State's university. One government provides the arrangement while the other produces the good (in this case, produces the courses, lectures etc.). This arrangement allows at least a small degree of flexibility in the public services of both States. Several States could be encouraged to compete for the contracts from other States. Efficient, quality services may result if open competition for contracts is allowed. Various States or local authorities can compete for the contract to produce the service.

SET D

Any movement away from area C, and C1 in particular, is a step towards the decentralisation of decision making and the privatisation of enterprise. Set D of Figure 2.1 contains probably the most controversial arrangements. Here the government arranges the provision of goods and services but allows private enterprise to produce them. This privatisation is not as radical nor as complete as divestiture but it is a clear step away from direct government production of goods. This form of privatisation allows the government to retain its role of provider for its citizens.

There are three arrangements in Set D. The least radical and the one that least qualifies for this group is the provision of a **grant** or **subsidy** to private producers of goods (D1). The grant ensures that essential goods are produced by assisting the private producers. A subsidy is, "any government measure which reduces the cost of production of a firm or industry below that level which would have obtained in the absence of that measure" (Burton, 1979, p2). A simple and common example is a milk subsidy. The subsidy makes the product more affordable for all the people. Other examples are grant aid to theatres, sports and to the producers of other educational and aesthetic goods. Unlike the voucher system (A4), consumer's choice is eroded in this case. The consumer is helped to purchase only certain goods. The government retains the power to decide which producers receive the aid and by how much. In this sense the subsidisation erodes freedom and conditions purchasing behaviour. Privatisation in this context would be the lessening of subsidies. Such a move may be necessary to allow market prices to operate more freely and to enhance consumer choice.

Subsidisation of industry is a legacy of Keynesian economic thought and earlier socialist philosophies. The degree of subsidisation in an economy is difficult to measure because of its often hidden nature. Subsidies can assume many guises, and can be difficult to detect. Examples of government subsidisation of industry include tax-free grants, low interest loans, depreciation allowances, investment allowances, regional development grants, resettlement grants, grants for restructuring or for modernisation, 'rescue packages' and grants to 'safegaurd employment'. The degree of subsidisation of industry in the British and Irish economies soared in the 1970s and early 1980s. Private companies used much of their energy to compete for government subsidies instead of competing in the markets (Burton, 1979, p48). In recent years the level of subsidisation has fallen. Governments have been less inclined to offer rescue packages to failed companies.

If the government is moving away from producing a good itself towards subsidising the private production of that good, a form of privatisation is taking place. If the objective is full privatisation, the level of subsidisation should not be so high that it excessively interferes with competitive markets. It should be designed to enhance competition. When open competition is allowed in the industry, the subsidy should then be abandoned. A free, market system will result and the privatisation will be complete.

Under the **franchise** system (D2) the government licenses a private firm to produce a good. By awarding the franchise, the government (franchisor) is privatising the production of the good. The consumer pays directly for the good. Like a market situation (A1), it is in the interest of the franchise company (franchisee) to produce efficiently and competitively. The consumer, presumably, can go without the good and the government can withdraw the franchise licence.

The franchise most common in the private business world is the 'business format' type. Mendelsohnn (1979, p3) explains that business formating, "involves the exploitation not merely of goods identitifed by a trademark or invention, but the preparation of the 'blue print' of a successful way of carrying on a business in all its aspects."

Adam and Jones (1981, p1) list three franchising arrangements:

(a) The manufacture under licence of patented products

(b) Distribution agreements e.g. cars

(c) Contractual licences under which the franchisee is permitted to carry on a business under a trade name belonging to a franchisor.

A government acting as a franchisor may involve itself in each of the three arrangements. The government maintains control over the service. It is essential that this control is exercised. From the franchisee's point of view, the advantage over opening up his own business is that he is producing a developed product and is protected by the large organisation (here, the government). There is less risk for the franchisee than would have been the case if he ventured alone. The government (franchisor), also gains because the franchisee whose capital is at risk works hard to make a success of the business. The public in turn benefit because they get an improved, modern and reliable service. Franchising, therefore, satisfies several of the goals of privatisation. It leads to less government, more competition and a more reliable efficient service.

Great care must be taken with a franchise system. It is unsatisfactory if the government merely takes monopoly power away from a public body and gives it to a private firm. This only changes a public monopoly into a private one. The franchise ought to be awarded on the basis of a competitive bid. A truly contestible franchise should result in conditions as competitive as if normal, open markets exist (Baumol, Panzor and Willig, 1982). The timespan of the franchise needs to be sufficiently long to allow the franchisee to earn a return on his investment, yet short enough to allow the government to reward efficient or penalise inefficient franchisees. The government must take great care that it does not leave itself vulnerable to legal difficulties raised by third parties. The initial agreement must clarify which party (franchisee or franchisor) will carry the blame in cases of public liability.

The consumer, too, may need continued protection. A monopoly franchisee may exploit its position and charge an excessive price. This is more likely to occur when the franchise has a long life. Some regulation may be necessary.

Such regulation may negate the advantages of this form of privatisation. Besides, awarding an exclusive distributorship franchise may breach EC competition law. The Treaty of Rome (Section 85) forbids member States to give favour to one firm over another in the settlement of agreements. Similarly national legislation outlaws anti-competitive practices. Franchises should be non-exclusive as in the case of taxi licences. There are hopes that multiple franchises may be awarded to private bus companies to 'produce' provincial bus services in Ireland (Business and Finance, 15 Feb, 1990, p12-15). Multiple, non-exclusive franchises promote competition and enhance consumer choice. The government continues to earn a revenue from awarding the franchises and to save from disengaging itself from the production of the service.

Adams and Jones (1981, p211), summarising the hazards of franchising agreements, warn that:

> The principal difficulty in drafting agreements is to impose as much control over the franchisee as possible in order to ensure uniformity and quality of service, while

at the same time avoiding possible collision with competition law, and avoiding creating a relationship which could result in the franchisor being held liable to third parties.

The final arrangement in Fig.2.1 is **contracting** (D3). This form of privatisation is widespread, especially in the USA. In Britain it is also common but has not attracted the same attention as the share flotation programme. Under the contracting arrangement the government pays a private firm to produce a service. It is different from the franchise system (D2) because here it is the government who pays the contractor and the consumer pays the government through taxation. (Under franchising the consumer pays directly for the good.) The government may own the facility (eg airport) but contracts a private firm to operate it. The government can retain control over the type and style of the service as well as the user-charge, if any. The government retains the right to withdraw the contract if the contractor has performed poorly. This threa is the contractor's incentive to produce a good service at a low cost. If the private firm delivers well it is rewarded with another contract. The firm may be penalised for slow or inferior work. The firm is answerable to the consumer and to the government as well as to its own shareholders.

A contract should be awarded following competitive tendering. This involves private contractors competing against each other for the contract. The contract is awarded to the firm most capable of producing an efficient service. There is no reason why government (in-house) workforce or departments should not enter this competition. In the event of the government department winning the contract, the contract price becomes its budget. This internal production of services is more likely in a large organisation. 'Contracting-in' is the term sometimes applied (Savas, 1987, p262) to the situation where both the public and privately contracted sectors deliver the service in the same area. This will often lead to great rivalry and sharp competition. Montreal supplies a refuse collection service in this way.

Any contractual (agency) relationship must deal with the incentive problem, sometimes called the 'moral hazard'. Harris and Raviv (1979) explain that a moral hazard arises, "because the agent would prefer to work less, other things being equal, while the principal is indifferent to the agent's effort, other things (i.e. his share of the pay-off) equal." For this study the principal is the government and the agent is the contractor. The government's aim is less likely to be a share of the pay-off than the provision of a quality, reliable service. A contract between the government and a private firm must include incentives for the firm to perform efficiently.

There are three main types of contract (Bamberg and Sprerman, 1987, p62, and McCall, 1970).

- -The first type is the 'cost plus fixed-fee'(CPFF) contract. According to this agreement the government will cover the cost of the service and pay an additional fee to the contractor. The contractor has no incentive to control costs.
- -A second type of contract is the 'firm-fixed-price' (FFP) contract. In this case the contractor is paid a pre-arranged fee. The contractor has to bear any cost over-run. On the other hand he can enjoy any cost under-run. The incentive to produce efficiently is clear. The threat of losing the contract will encourage him to produce a quality service.
- -The 'fixed-price incentive' (FPI) contract is a third type. A target cost is set. If the actual cost is less than the target cost the gain is shared by the government and by the contractor. The incentive is similar to the FFP contract. Taxes may be deducted from the cost of the fee as they constitute a rebate to the public.

The difficulties in a contract agreement include determining the target cost and the target profit (and therefore the risk). These parameters could be made part of the competitive bid. The contract would then be awarded to the firm with the most agreeable targets. There is a danger that a contractor will propose a low price in order to win the contract, only to increase the price after the government has become dependent on him. There is also the danger that efficient (low average cost) firms may overstate the estimated cost in order to maximise profits while inefficient (high average-cost) firms may under-estimate cost in order to win the contract. The government may then choose the inefficient firm.

The success of the contracting-out of government services depends on many factors. The contracted firm is more likely to perform efficiently and competitively if the threat of withdrawal or cancellation of a contract is a real one. The period of the contract must not be excessively lengthy for fear that the contractor may again become a type of monopoly. Care must be taken that the contractor does not have an incentive to behave strategically over the contract period (Blankart, 1987). On the other hand, the contract period ought to be sufficiently long to allow a reasonable return on capital employed. It is unfair and uneconomic to withdraw a contract from a firm if it has invested heavily on the necessary capital. The period of the contract should approximate the lifespan of the assets, *ceteris paribus*.

Contracting-out allows the government to benefit from private business expertise. Governments become less bureaucratic and more market responsive. The contracting-out of some parts of a service provides information on the effect of contracting-out all of the service or, indeed, of complete divestiture.

Many of the criticisms of contracting-out resemble those objections to privatisation discussed in Chapter One. Of particular concern is the effect on employment and wages. Labour unions fear that contracting-out inevitably results in redundancies. What is to happen to public workers whose jobs have been newly awarded to the contracted firms? (To satisfy the unions, US legislation guarantees six years pay to federal workers who are laid off as a result of competitive contracting. There have been, therefore, few such redundancies.[Walker, 1988, Ch 12])

A second fear is that contracting-out legitimises low wages. The most common area of contracting is in lowly paid jobs like cleaning and catering. A growth in the number of contractors can result in a multitude of under-paid workers. In Britain this fear of exploitation has been made worse by the abolition of the Fair Wages Resolution (1946) in the 1982 Finance Act. In effect there is now no minimum wage.

The contracting-out process may have a huge ill-effect on all public servants. As their job security is threatened by the contracting, their morale, loyalty and productivity may suffer.

Another argument against contracting-out is that a contractor's sole aim is profit maximisation. Neither the contracted firm nor its employees have a direct loyalty to the State or to the public. But this argument can be challenged by a point made earlier in this chapter. It is the pursuit of profit and of the renewal of the contract that inspires contractors to produce an efficient and quality service.

The contracting-out of public services is most common in the USA. Contracted firms not only provide cleaning and catering services but are entrusted with running State-owned hospitals, schools and prisons. La Mirada, a Californian city of 40,000 people, contracts out over 60% of services and employs only 55 public servants. Widespread contracting-out is happening in Japan and Switzerland. Denmark has a long tradition in the private provision of emergency services. (The Falck Company, for example, has supplied fire services there for generations [Ascher, 1987, Ch1]). Private firms have maintained public parks for many years in West Germany.

The British public service has a high incidence of contracting-out. 84% of civil service cleaning, 73% of its laundry and 81% of maintenance were performed by contracted firms in 1986 (Institute of Public Management, 1986, p13). Refuse collection, transport, traffic signal maintenance, security and some health services (including some operations) are contracted out (Butt and Palmer, 1985, p149). The UK Local Government Planning and Land Act 1980, mandates local authorities to contract-out, through competitive tendering, the production of many of its services. 1987 legislation forces local authorities to contract-out many other key services. It also prohibits the consideration of non-commercial factors for the awarding of contracts (except where racial discrimation is feared). The 1988 Local Government Act mandates local authorities to open all refuse collection, grounds maintenance, street cleaning and other services to competition (Harrison, 1989; Rowlinson and Tanner, 1989, p62). The success of the contracting-out in Britain has been mixed. Although savings have been made, some contracts have been terminated because of poor quality (Thomas, 1988, p164). Encouragingly, in-house producers have occasionally won back the contract work.

The competition to win public service contracts in the UK has been frantic. The cleaning, catering and textile maintenence (rental, laundry etc) industries are highly competitive despite being dominated by just a few firms. The contract catering industry is controlled by two firms, Trusthouse Forte and Grand Metropolitan. They compete in a huge market with a low profit margin (Ascher, 1987, Ch3). Competition is most keen in the struggle to win public service contracts. Both firms benefit from economies of

II DEREGULATION AND DIVESTITURE

Figure 2.2 is a second presentation of the arrangements examined in this chapter. Here they are listed according to the degree of privatisation involved. Government production of services is, of course, furthest away from a private arrangement. Moving down the pyramid we move into wider spaces where more competition and freer forces are allowed. The area of each block is directly related to the level of competition involved and, in a sense, the degree of efficiency attainable.

PRIVATISATION IS ANY MOVEMENT DOWN THE PYRAMID.

FIGURE 2.2

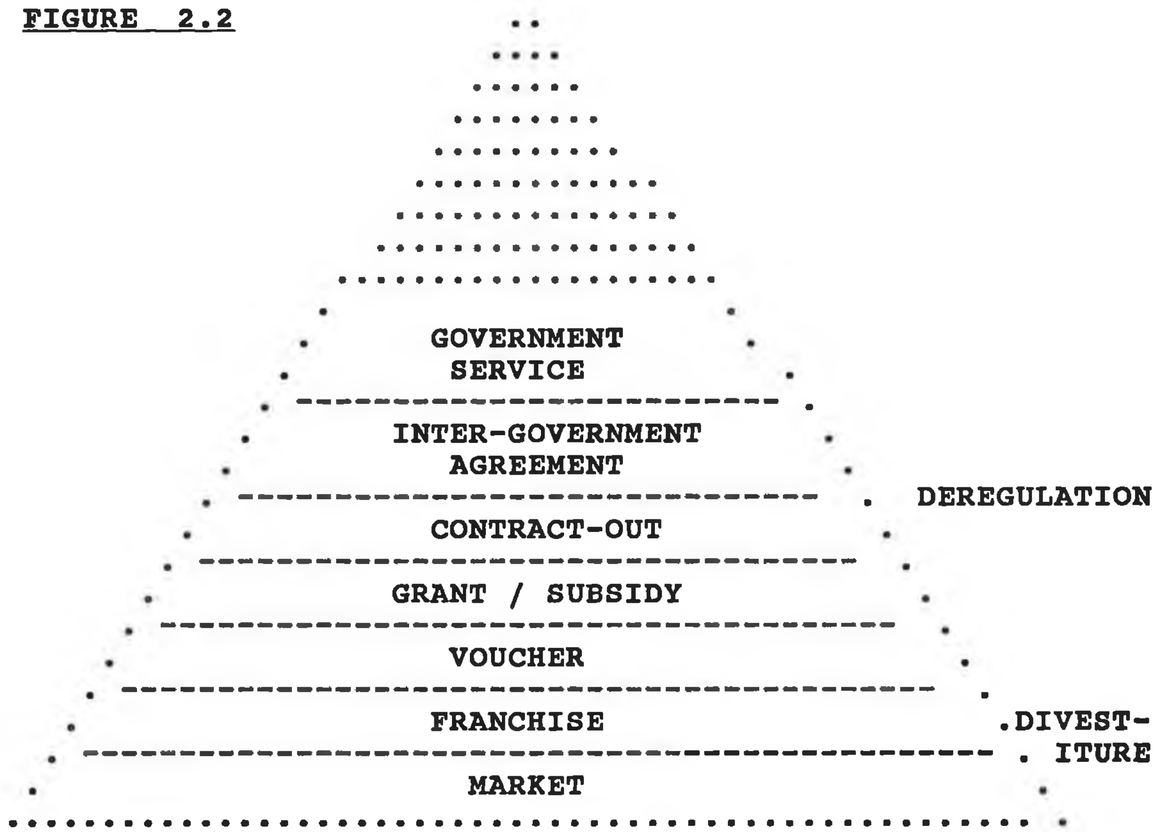

Figure 2.2 DEGREES OF DEREGULATION

Note that franchising is closer to market forces than contracting-out because under the latter, people's choice is restricted. Similarly, a voucher is more competitive than a grant/subsidy system.

Outside of the pyramid are two of the moves that a player (government) can make: deregulation and/or divestiture. Deregulation is a slow, cautious and often wise prerequisite to privatising. Divestiture is more complete and bold.

Deregulation is the removal of procedure, laws, rules or regulations that protect either public or private producers, or in some way prevent entry or exit from an industry, or impose restrictions on the freedom of action of those producers. Deregulation may be liberalising or may indirectly restrict a consumer's right to clean air or a quiet environment etc..

In the USA, for example, deregulation has taken place in broadcasting, bus services, railroads, oil, gas, airlines and telecommunications. The US Civil Aeronautics Board, for example, promulgated deregulation that resulted in twenty new airlines in the period 1980 to 1986. Similarly, the breaking up of the American Telephone and Telegraph company (AT&T) has allowed much greater freedom in communications. Britain, too, has passed widespread deregulatory legislation. Again the telecommunications industry was deregulated by creating a new company called Mercury to rival BT's supply of telecommunication services. Broadcasting, transport and the legal profession have also been widely deregulated. Ireland has recently deregulated financial services and commercial radio to some extent.

Deregulation does not imply privatisation. Deregulation can occur while an industry remains in public hands. Although often meant as an alternative to privatisation, deregulation usually becomes a first step in the privatisation process. Governments, especially in Britain, have used deregulation as a stepping stone towards a near complete withdrawal from a public company.

Britain has popularised the method of privatisation called 'divestiture'. This move has two main mechanisms:

> (a)The conversion of public corporations into companies and the subsequent sale of a majority of the company's shares. (b)The sale of a particular public corporation or part thereof to private sector firms or institutions. (Grant and Nath, 1984, Ch3)

A sale may be by a fixed-price share flotation or by competitive tendering. A fixed-price share sale is the easier to organise and is the more successful in attracting the small investor. Britain used this method to sell parts of corporations such as, British Telecom and British Gas.

Its difficulty is deciding the share price. Britain's Cable and Wireless was sold at 168p per share but traded at 197p on its first day and later reached 435p. On the other hand, Britoil was floated at 215p per share but traded well below that price. These share flotations were also hugely expensive.

Sale by competitive tendering is more likely to maximise government revenue. Batches of shares are sold to the highest bidder. This is a complicated system and may crowd out popular support. Its secretive nature can be helpful or corruptive. Because details of the tenders are not usually revealed, the government can choose whom it likes. In 1986 the Vickers Shipyard was sold to the second highest bidder. The successful bidder was a consortium of the company's managers and workers. Their bid was preferred over a higher bid by the Trafalgar House Group (Pirie, 1988). The Italian government sold Alfa Romeo to the Fiat Group despite a higher offer by Ford.

Britain used both fixed-price share flotation and competitive bidding to sell British Airports Authority. One quarter of the corporation was sold using the former method while the remainder was sold through the latter method. This compromise ensured good government revenue from the sale and allowed an opportunity to small investors (of whom only those seeking less than 1000 shares received an allocation).

An alternative method, yet untried, is the discount sale. In this case the shares are sold at a discount to the market price for the share on the day of sale. The government can announce, say, a 50p discount so that if the market price on the day of sale is 400p per share, the new shares are sold for 350p. The buyer is guaranteed a 50p premium. The government is guaranteed a sale. There is no need to underwrite the issue. This saves a considerable amount of money. The discount sale is only possible when the company's shares are already trading in the market. It is suitable when a second or subsequent tranche of shares in a company is being sold. It may be appropriate for Ireland to sell a further stake of Irish Life or Greencore in this way.

A company's shares may be sold by 'placing' them with established institutional investors. Many French privatisations were operated by 'placing'. In 1992 a second tranche of Greencore shares was sold through a private placing. Although this method does not widen popular share ownership, it has the advantage of being simple, quick and cheap. Like any sale, the timing of the placing is crucial. For political and strategic reasons, concern may arise if many of the institutions that receive a placing are foreign owned.

Managerial and employee buy-outs are less publicised ways of selling State bodies. An MBO or EBO gives workers a real input into their company's future. By feeling more influential, the employees-cum-owners will work more energetically and the company will become more productive and more profitable. That is the theory. The Economist (13 March, 1982) noted that, in practice, EBOs resulted in "little shift in workers control or deregulation of decision making. Conflict and debate re-emerges some months after. Experiments often revert back to conventional ownership." Yet the Japanese management structure in which managers are usually appointed from within the staff, has been successful for a long time.

By 1992 Thatcher governments had raised £35 billion by the sale of State companies and assets. Chapter One referred to many examples of divestiture throughout the world including an early experiment in British Columbia. There all the public corporations were sold *en masse* through a holding company designed for the task. Likewise, the German Trust Company, *Truehandenstalt*, is currently selling or liquidating many thousands of businesses in the former GDR.

The 1991 sales of Irish Sugar and Irish Life indicate a clear policy shift in Ireland. The government has planned a five year privatisation programme with the aim of reducing the national debt. The programme began with small sales of government real estate. Further large scale flotations will depend on the government's ability to overcome the effects of the scandals surrounding Irish Sugar's acquisitions. The expected privatisation of Telecom Eireann will be delayed significantly because of the controversies regarding its acquisitions. Ireland's privatisation options are the focal point of Chapter Five.

New Zealand's socialist government has nurtured a type of privatisation called 'corporatisation'. State bodies are being converted into real, autonomous corporations. Government interference is next to none. This is one step further than Ireland's familiar semi-State corporate structure. Corporation is a step towards privatisation.

More detailed analyses of the deregulation of specific State industries and the sale of State companies throughout the world is presented in Part Two.

III TYPES OF GOODS

The ease or difficulty in privatising an industry may be influenced by the nature of the good produced. Savas (1987, Ch3) distinguishes four types of goods and services. Figure 2.3 illustrates the important features of these goods.

FIGURE 2.3

	Easy to deny access	Difficult to deny
Individual Consumption	**Private**	**Common-Pool**
Joint Consumption	**Toll**	**Collective**

Figure 2.3 FOUR TYPES OF GOODS (Adapted from Savas, 1987, Ch 3)

For the purpose of this study the goods are distinguished by two qualities:

(a) Can access to them be denied to non-paying consumers i.e. is exclusion possible?

(b) Can they be consumed jointly or is only individual consumption possible?

Most goods are **private goods**. They are consumed individually and they are accessible only to those people willing to pay. These goods are supplied by the market-place although the government may supply them if they are deemed to be specially beneficial. Privatisation of the production of these goods is a viable option.

Toll goods are also available only to those people prepared to pay. Unlike private goods these goods can be consumed jointly by a number of consumers. Many toll goods are natural monopolies. That is, the cost per user decreases as the number of users increases. Examples of toll goods are satellite t.v. and toll-bridges. Many toll goods are supplied by the government (DART, RTE). The consumer is charged directly (travel ticket, t.v. licence) and/or indirectly (taxes). The production of these goods can be privatised. Such a change would require regulatory legislation to safeguard prices and quality.

Common-pool goods are those supplied by nature. Their supply in that sense is infinite (ignoring the Greenhouse Effect etc.). Because of their infinite supply, access to them cannot be denied. They cannot demand a price. Air and the Moon's beauty are extreme examples of common-pool goods. These goods are non-tradable and their production may not be privatised.

Collective goods are goods whose access is not deniable. They are not supplied by nature but neither will they be supplied by the market. It is left to the government to supply these goods. Examples of collective goods are State defence and rat control because everyone benefits from them (except the enemy and the rats!). A simple illustration of a collective good is a lighthouse. It is consumed (i.e. its warning is registered) by everyone in the vicinity. Its consumption cannot be denied. Everyone benefits from its being there. The consumer has little influence over the quality or quantity of collective goods apart from his power as a voter. Private entrepreneurs have no interest in producing these goods because the consumer cannot be charged. (Sometimes a collective good can be made into a private good. To do this exclusivity must be feasible. The lighthouse could, instead of beaming light, project microwave signals detectable only by receivers rented by paying consumers. Only then can the production of these goods be privatised.)

Private and Toll goods are amenable to privatisation. Because of their exclusivity, private entrepreneurs are willing to produce them. Common-pool goods may not be privatised because they can demand no price. Voluntary action to enhance the beauty, quality and longevity of these goods is becoming increasingly more popular. Collective goods need concerted altruistic promotion. Again the voluntary sector may supply these goods. It is more likely, though, that the government will be the only body willing to provide such collective goods as traffic wardens, pavement repairs and defence. But as we have seen in this chapter the government may continue to provide these goods but allow (contract etc.) private firms to produce them.

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PART TWO

THE PRACTICE OF PRIVATISATION

CHAPTER THREE

PRIVATISATION IN THE UNITED KINGDOM

I THE PUBLIC SECTOR

State-owned enterprise emerged in Britain in the late nineteenth century. In those early days State intervention was mainly in the provision of utilities such as gas, electricity, post and housing. As technology and the economy grew so, too, did the public sector. The State* created new enterprises such as the Post Office in 1906. Sometimes the government bought major stakes in large companies such as the Anglo-Persian Oil Co. (later BP). The World Wars led the government to totally subsume many private industries including coal, iron and steel, and banking. Nationalisation became a major policy drive of the 1945 Labour Government. Many of the publicly owned companies discussed in this chapter were nationalised in the immediate post-war period.

This purchasing tide was stemmed by the three Conservative Governments of 1951-1964. However, the tide was not reversed. Apart from steel and some subsidiaries, the nationalised companies remained in public hands. In 1964 the Conservative Party criticized Labour's nationalisation policy as "economically disastrous and incompatible with the opportunities and responsibilities of a free society" (Fraser, 1988, p5). The Conservatives fought the 1970

* NOTE: *(Words such as 'government' and 'state' in this chapter refer to the British government etc. £s are pounds sterling.)*

election with a firm policy of 'disengagement'. There should, they said, be "less government". During the Conservative Government term of office 1970-1974 the State-owned travel agencies, Thomas Cook and Lunn-Poly were privatised. So, too, were the Carlisle and Scottish State-owned public houses and Rolls Royce (car manufacturers) (Young and Lowe, 1974, p140). The government also widened competition in the airline industry by creating British Caledonian. The Conservative disengagement policy was generally low-key but, perhaps, the seeds of the privatisation programme were sown during this time.

Labour returned to power in 1974 with a manifesto no less enthusiastic about nationalisation than at any time since the war. It planned to take into public hands industries such as pharmaceuticals, aircraft frames, aero-engines and oil exploration, in fact any business:

> Where a public holding is essential to enable the government to control prices, stimulate investment, encourage exports, create employment, protect workers and consumers from the activities of irresponsible multinational companies, and to plan the national economy in the national interest. (Labour Manifesto, 1974, in Fraser, 1988, p7)

This policy helped the Labour Party to win the two elections of 1974, albeit with a declining majority. Around this time the Labour administration created the National Enterprise

Board (NEB) through the White Paper <u>The Regeneration of British Industry</u>. The Board's directive was to co-ordinate the development of the State-owned sector. Most of the Board's early years were used in aiding the troubled Rolls Royce (Aerospace) and British Leyland companies (Kramer, 1988, p5).

By the end of its term in office the Wilson government had recognised that the public sector was grossly bureaucratic, top heavy, inefficient and mismanaged. Although there were no plans to abandon State involvement, the Labour Government recognised the need to restructure the public sector and, in particular, the relationship between the public enterprises and central government. Hitherto, any failure in the nationalised industries was thought to have its source within the nationalised industries themselves. Now it was time to review the government's own role.

There are three forms of public ownership in the UK (Vickers and Yarrow, 1988, Ch 5):

<u>TYPE A</u>: The industry is essentially a department of State under the direct control of a minister. Examples of Type A are British Airways Authority (BAA) before 1965 and British Rail.

<u>TYPE B</u>: The State maintains a sole or a majority shareholding in a commercial company which is otherwise ordinary. Examples of Type B are Rolls Royce (RR), Cable

and Wireless (C&W), Shorts.

<u>TYPE C</u>: A company that is subject to broad government policies and directives but is fully autonomous with regard to day to day management. Its board (typically appointed by the relevant minister) is free to manage, although constrained financially. Such a company is called a 'public corporation'. The idea is that the arms-length approach of the government allows the company to act freely and responsibly. The board should act as "high custodians of the public interest" according to Morrison, the Labour minister who developed the concept in the 1930s. Examples of public corporations are British Rail (BR) today and British Telecom (BT) before its privatisation . Public corporations have been the main focus of privatisation and require special attention here.

The control of a public corporation is hierarchal. The relevant minister and his/her government are responsible for the strategic plans of the company. They impose statutory duties upon it. The government may also impose White Paper guidelines and financial constraints. The corporation is also answerable to House of Commons investigations and (like any other company) to Mergers and Monopolies Commission (MMC) examinations. Apart from these pressures the public corporation's board is allowed to act freely. The board has no incentive to act efficiently except to remain within the financial constraints (if possible) and perform its statutory duties. These constraints were often no more than "break even" over a period of time. The statutory duties were equally vague, such as "run an efficient business".

Recognition of the problems led to a number of changes. In 1961 each industry was set a specific rate of return. These remained no more than targets. There were as yet no real incentives. A 1967 White Paper suggested more specific requirements: prices should reflect long run marginal costs; there should be no cross-subsidization; in their accounts non-commercial activities should be presented separately; and investigations should be judged by a "test discount rate" (Pryke, 1983, p258). Vickers and Yarrow (1988, p146) report that even recent studies show that the Post office had "no information on marginal costs", British Telecom (BT) (pre-privatisation) over-priced trunk calls and under-priced local services (i.e. cross-subsidization) and National Bus practiced "significant cross-subsidization".

The 1967 White Paper succeeded in creating more control but the problem of motivation remained. The National Economic Development Organisation 1976 inquiry into nationalised industries (<u>A Study of UK Nationalised Industries</u>) was the biggest of its kind. It criticised the vagueness of the government's plans and controls. It suggested that policy councils be assigned to each industry. The government replied with their 1978 White Paper. They rejected the policy council suggestion but the ministerial role was diluted, slightly. Indebtedness was restricted and the 'test discount rate' concept was dropped in favour of a 'required rate of return' for each industry. This 1978 approach may have worked well. It is difficult to judge because very soon after that date a very different approach was adopted.

About this time the Institute for Economic Affairs in London wrote against public expenditure. Heald summarises the Institute's main policy conclusions as follows:

- Services should not be provided free of user charge....
- Wherever possible, public provision should be replaced by private provision.
- Choice can be restored to public services by the use of vouchers.
- Whatever income redistribution is desired should be implemented through cash transfers and not benefits in kind. (Heald, 1983, p90)

The policies promoted by the Institute and the fresh ideas of the new Conservative Government changed the approach towards State ownership and public sector management.

II THE PRIVATISATION PROGRAMME

The 1979 Conservative Manifesto never mentioned privatisation. The word itself was not popularised until later. The Conservative's denationalisation plans were, in hindsight, unadventurous and modest. There were three pledges relating to divestiture:

i. Sell British Shipping
ii. Sell British Aerospace
iii. Sell National Freight Corporation

The manifesto also planned for the relaxation of bus licencing and a review of the British National Oil Corporation (later 'Britoil'). Mrs Thatcher's first and subsequent governments went a great deal further than proposed in 1979. Mrs Thatcher inherited a public sector that employed 2,065,000 people and contributed £18,000 million to the UK GDP (10.5 % of total). The net capital stock of this sector amounted to a massive £104 billion (17% of total) (Vickers and Yarrow, 1988, Table 5.1). Ten years later the privatisation programme had helped to reverse the UK's Public Sector Borrowing Requirement (PSBR) from a £12.5 billion deficit in 1980/81 to a £12.5 billion surplus in 1988/1989 (CSO, 1990, Table 17.7).

Thatcher and her colleagues on the Right believed that privatisation achieves a number of valuable goals:

i. Revenue from sales reduces the country's (then) crippling PSBR.

ii. Privatisation results in freedom from ministerial interference and, on the other hand, pressure of competition encourage greater efficiency.

iii. Wider share ownership creates a 'popular capitalism' encouraging voters to favour the Conservative party over the Labour party.

iv. Privatisation allows less direct government involvement and less government interference in people's lives.

These objectives grew in importance as the privatisation programme progressed. Economics and politics were fudged to create a privatisation crusade that became an essential element of 'Thatcherism'. The government off-loaded such giants as BT, British Petroleum (BP), British Gas and the water and electricity supply industries. The privatisation programme is behind the current campaign of the 'opting-out' choice for schools and hospitals and the deregulation of rail transport.

III THE PRIVATISATION PROCESS

The British privatisation programme began quietly with some minor sales. (These and other sales are examined later in this chapter.) Reviewing the government's experience of privatisation reveals how each one was a learning exercise.

Many privatisations were bigger than most attempted before. Sales increased in complexity, scope and ambition. It has been with great skill that ministers and their advisors have prepared each privatisation package. Although each process differed, a general pattern emerged. This pattern is outlined below. (The ideas below are based on Ramanadham's 1988, Appendix p262 and Veljanouski, 1987, Ch6 and on my own observations during research.)

i. The first step in the process is to commission a feasibility study. The report of this study presents the options available. It may advise that privatisation be postponed or cancelled. The relevant minister may decide to proceed with privatisation subject to a number of adjustments. This may begin with the appointment of a new, agreeable chairman to the board of the targeted public corporation. The government replaced Lord Kearton, chairman of British National Oil Corporation (BNOC), when he sought the cancellation of his corporation's privatisation. In his place the government appointed Mr (now Sir) Philip Shelbourne, a supporter of privatisation (Steal and Heald, 1985). Boards of the public enterprises are, usually, in favour of privatisation provided that their corporation is not broken up. The government, too, opposes the dismantling of public corporations because that reduces the revenue raised by their sale. But, as discussed in Chapter One, allowing the corporation to remain intact does little to increase competition in the industry.

ii. If privatisation is to go ahead the assets of the corporation are usually transferred to a successor company registered under the Companies Act and wholly owned by the Crown. The government may then decide to sell up to 100% of the company. In cases where the enterprise was already of the Companies Act type (such as C&W and Amersham International) the legislation required has been much more simple.

iii. There are often many other changes necessary before proposals for privatisation of the company are released:

- The company's 'public good' duties may be removed.
- Some regulation will be required for the period after privatisation. The regulatory duties are usually shared by the relevant government minister, the MMC and a special regulatory body (such as the Office for Water Services, OFWAT). In some cases the regulatory framework necessary after privatisation seems as cumbersome and as intrusive as direct government ownership and involvement.
- The accounting procedures may have to be modernised in line with procedures required by the Stock Exchange. In general a more open, informative approach will be expected of the new privatised company. Typically the accounting practices of State-owned enterprises are obscure and without detailed information. For example, British Telecom before 1981 employed one accountant and produced no figures for true costs of providing any

of its services as a whole, let alone to any one customer (Veljanouski, 1987, p124). National security was the Ministry of Defence's excuse for not providing any accounts for Royal Ordnance (makers of tanks and munitions). As a result, Royal Ordnance could not be floated in the usual way. In the end it was sold quietly to British Aerospace (BAe).

- The track record of the company may have to be made more attractive. The corporation's gearing and debt:equity ratio may have to be improved. A high gearing or a high debt:equity ratio reduces the corporation's value. There have been some extreme cases of pre-privatisation rationalisation. The 1982 loss of British Airways (BA) included a rationalisation bill of £400 million. The sale of Rover was preceded by the government writing off £1,100 million of tax debts. The government also agreed to inject £800 million into Rover to cover trade debts. The company itself was sold to BAe for a mere £150 million.

iv. If the corporation is deemed ready for sale an enormous task remains. Having prepared the company for the market-place, a market must be prepared for the company. Simultaneously, legislation must be passed to make everything possible. A Privatisation Act will usually remove statutory duties from the corporation and create in its stead a public limited company which may then be sold. The new legislation must also detail whatever regulatory system is to be imposed.

v. An essential element of regulation is the pricing system, of which the best known is the Littlechild formula for BT (Littlechild, 1983). Littlechild's formula was simply, **RPI - X** where **RPI** is the retail price index and **X** is a real number greater than zero and less than infinity. The formula meant that in any one year the weighted average increase in prices charged for BT's domestic services must be at least **X** percentage points below the inflation rate of that year. The government agreed on this formula and decided that **X** should equal 3 for the first five years. The agreed increase (say 4% if inflation is 7%) need not apply to any particular service but must be the average price increase. In view of this, a restriction was imposed on price increases for residential line rentals: any annual price increase cannot exceed **RPI + 2** (The Telecommunications Act, 1984). The BT price formulae will be examined later in this chapter. At this point they serve as examples of the government's price regulation. Further elaborate and flexible price formulae were adopted for the privatised water and electricity supply industries.

vi. There is another, more immediate price problem. That is the price of the corporation about to be privatised and, if floated to the public by a fixed price mechanism, the price of its shares. At this point the government has other decisions to make: how to sell the corporation, to whom and for how much. There are several options each of which has been adopted by the British government and none of which should be overlooked by an Irish one. These are examined below.

SALES METHODS

A. Management Buy-Out (MBO); Employee Buy-Out (EBO)

This option is the easiest to achieve. The costs are low. There is no advertising and no underwriting. The selling price is decided through negotiation. A company owned by management and/or employees has an obvious incentive structure that should result in efficiency. One problem, however, is that the corporation if hitherto a public monopoly may become no more than a private monopoly. The government's new legislation will be vital in creating and encouraging competition. Examples of MBOs/EBOs have been the National Frieght Corporation which was sold to staff and management, and Hoverspeed, sold to its directors (later bought by Sealink).

B. Trade Sale

In this case the corporation is sold intact to a single buyer. The procedure is quick, cheap and relatively risk-free. But there may be problems of monopoly power. Sealink was sold complete to British Ferries (itself a subsidiary of Sea Containers) for £66 million. The controversial sale of the Rover group to BAe was noted above. The government has been keen to ensure that public corporations are not sold directly to a foreign investor. Such a loss of sovereignty can be politically sensitive. Ironically, it was this reluctance to sell the Rover Group to a foreign company that led to a more controversial arrangement. The government has been further embarrassed by the 1989 sale of Jaguar (privatised in 1984) to America's Ford.

C. Private Placing

This form of sale is direct and uncomplicated. It involves the sale of the company to private instiutions via their stockbrokers. Revenue raised can be great although the timing of the sale is very important. A distinct disadvantage is that there is no general widening of share ownership.

D. Hybrid Arrangements

Methods A, B and C may be applied simultaneously. For example, 38 of the National Bus Company's subsidiaries were sold to management or employees, another 24 were placed privately and the others were sold through a combination of the two. One subsidiary, Victoria Coach Station was sold direct to London Regional Transport, itself a public body.

E. Offer for Sale

Few of the above sale methods have generated much public scrutiny. The most notorious method has been the public offer. This is most people's understanding of privatisation.

There are two separate methods: fixed price and sale by tender.

The fixed price offer is the sale of shares at a pre-determined fixed price. Most of Britain's major flotations have been arranged in this manner. For some the fixed price was payable in instalments. Knowledge of the price is an attractive simplification for the prospective small shareholder. Initial premiums can be assessed by onlookers and may encourage others to buy new shares in subsequent privatisations. In this manner the objective of widening share ownership can be achieved more easily. In many cases premiums earned were very attractive. The government was frequently criticised for sellling State assets at too low a price and allowing excessive premiums. By the end of the first day of trading, the price of the new BT share (1984) had risen by 80%. The price of Rolls Royce shares rose from 170p to 288p in the first week of trading. Significant premiums were also earned on shares of the Trustee Savings Banks (TSB) and British Airways (BA). (See Table 3.1, below)

A variation of the fixed price offer is setting the sale price at a pre-determined discount. Buyers are guaranteed a price which is, say, 30p below the prevailing market price at the time of sale. This method is only appropriate if the company's shares are already being traded. An advantage of this method is that there is no need to underwrite the issue.

Setting the fixed share price has been a difficult task. The government, keen to maximize revenue from each sale, was concerned not to crowd out the small investor. Politically, setting the price too low would arouse further opposition to the government's privatisation programme while setting it too high, causing under-subsciption for the shares, would be a sign of failure. On balance the government preferred to set the share price on the low side to secure a successful and popular sale.

An offer for sale by tender is auctioning shares to the highest bidder. When a sale is announced interested parties are invited to bid for shares by tendering a secret offer price. The government, viewing the demand for shares at various prices may easily decide on that price that maximises total revenue. This price having been effectively determined by the market should approximate the share's subsequent stock exchange price. The success of tender offers in British privatisations has varied. Although revenues have been near maximised and premiums low, miscalculations have occurred (see the cases of Enterprise Oil and Britoil) and little progress was achieved in widening share ownership.

The British government has used both fixed price and tender offers in their privatisation sales. The first three privatisations of note (BAe, C&W and Amersham International) were all fixed price sales. Each was heavily oversubscribed. The government, although delighted with the successes of these sales, was concerned that their State-owned enterprises were being sold too cheaply. The next major sale, Britoil (1982), adopted the tender price method. The equilibrium price of 215p was clearly miscalculated as the offer was heavily undersubscribed. (But from a revenue point of view the Britoil sale was highly successful as the unsold shares were bought up by the underwriters.) The government then returned to the politically, if not fiscally, more reliable method of fixed price when they privatised 51.5% of Associated British Ports (ABP) in 1983. However, the fixed price of 112p was oversubscribed 35-fold. That is, 35 times more shares were sought than were available. Apparently, early lessons had not been learnt. The sale of BAA in 1987 was a combination of fixed price and tender methods of sale.

COSTS

Before deciding to sell, the government must consider the costs. If a share flotation is the chosen method of sale, costs are at their highest. These costs include advertising, underwriting, printing the prospectus, paying solicitors, advisors etc, and paying the stock exchange listing fee. The latter two of these costs have been enormous. In the case of British Gas (1986) these costs totalled £360 million and the sale of BT in 1984 cost £263 million. The roles of advertising and underwriting are examined below.

A. Advertising Costs

The British government's desire to widen share ownership through the flotation of State-owned enterprises necessitated intensive promotional campaigns. The government's main fear was that a major privatisation would fail. Failure to attract a large number of small investors was feared more than a failure to maximise revenue. The fear was greater the larger the flotation. The sale of BT (1984) was the largest of any throughout the world. To ensure its success (and the political fortunes of the Conservative Party) a giant promotional campaign was unleashed. The promotion of BT's flotation serves here as an example of the advertising necessary in the privatisation process.

In 1984 the campaign to sell BT ranked in the top ten of the most heavily advertised brands in the UK. While Whitehall prepared legislation and regulation necessary for BT's sale, the Dorland Advertisement Agency (owned by BT) designed and conducted the advertising. The first stage was to educate the public (prospective buyers) about what BT actually does. Most of BT's own customers associated the company with their telephone. It was now necessary to enlighten them about BT's diversified activities and its high-tech, international concerns in particular. The advertising slogan, 'The power behind the button', sought to present a dynamic company whose activities and importance goes far beyond the telephone service. Newspaper, magazine and television advertisements attempted to present BT as the irreplaceable link in the commerce chain. The British people were made to feel good about BT's Britishness. One advertisement showed how a multinational oil company's North Sea rig depended upon BT's services for its transglobal data and communication lines.

Having increased people's awareness of BT, it was necessary to prepare them for BT's sale and to encourage them to involve themselves. Karin Newman (1986) explains that this advertising process was divided into four stages: Alert, Maintenance, Action and Prospectus. Each stage was designed to deepen the public's understanding of and interest in BT's imminent privatisation. The description of the stages below follow Newman (1986).

STAGE ONE

The Alert phase of the campaign began on August 20, 1984, fourteen weeks prior to the flotation. Its aim was to inform the public that BT will be privatised and that the public can apply for its shares and that one can apply by telephone or by writing. The advertisements' main message was that anybody can apply. Typically the advertisements gave examples of people from all strata of society, each of whom were eligible to apply. Clearly the government's aim to widen share ownership dominated the design of these advertisements. Other more technical information was less emphasised or omitted. A closer reading the advertisements revealed that the minimum investment was £250 of which only half would be required as a first instalment.

STAGE TWO

The next stage in the campaign was the Maintenance phase. This ran seven weeks beginning 14 September, 1983. Its aims were to reinforce the message already presented and to provide more information on the sale. The flotation of BT was raised to a national concern. Television and newspaper advertisements again emphasised that BT shares would soon be available to everyone regardless of their profession. The process of buying shares was explained simply. Newspaper advertisements posed and then answered questions such as, 'Suppose I answer this ad today, what happens next and when?' Coupons were usually provided allowing readers to obtain more information

STAGE THREE

Beginning Nov 15, the ten day Action phase of the campaign used all of the media. Its aims were to further encourage investment and to instill some urgency. It also further explained the process and revealed how the prospectus may be obtained. The advertisements focused on two specifics. Firstly, they empasised the £250 minimum investment, payable in instalments. Secondly, they presented a dramatic countdown to the day of the prospectus's publication.

STAGE FOUR

The Prospectus phase began on Nov 20 when the prospectus was published and the share price announced. A shorter version of the prospectus appeared in all of the major newspapers together with an application form for shares. By this stage all had been revealed. Indeed the only concern was that the success of the promotional campaign would result in massive oversubscription. The emphasis switched from interesting people in an application form to encouraging them to complete and return it. Again a dramatic countdown to the final date for the receipt of applications was conducted in the newspapers.

The scale of the promotion was huge. Undoubtedly, it contributed greatly to the sale's outturn. Over two million applications for the three billion shares were received resulting in the offer being five times oversubscribed. Perhaps the greatest achievement was in advertising, "a totally unfamiliar product the price of which was unknown practically until the end of the campaign" (Newman, 1986, p118). BT's £11 million advertising campaign was later dwarfed by British Gas's 'Tell Sid' promotion. Subsequent campaigns became more polished and more expensive.

B. Underwriting Costs

A second, large expense of privatisation is underwriting. This is the government's insurance against the sale's failure to arouse public interest and to raise revenue. It guarantees a reward for the government. The cost of the guarantee, like any insurance, is considerable. The government paid £74 million and £60 million underwriting BT and British Gas, respectively (Veljanouski, 1989, p213) and £70 million underwriting the BAA issue (Heath, 1988).

The underwriting process works as follows (Grimstone, 1988). An issuing house buys shares at a given price. The brokers of that house lay off most of this risk to sub-underwriters (often pension funds) who are prospective long-term shareholders. The issuing house offers the shares to investors. Usually the investors buy these willingly. If shares are not bought by investors they are taken up by the sub-underwriters as per prior agreement. Regardless of the outcome, the broker, underwriter and sub-underwriters earn commission. Therein lies the cost. The system guarantees revenue for the government and provides confidence for the market. (An example of when the underwriting process did not quite work as expected is explored below in the case of BP.)

Mayer and Meadowcroft (1985) point to a particular failure of the underwriting system. Typically, a tender offer is underwritten by a City institution. These same institutions are prime bidders for shares:

> Since a failure of a bid to be fully subscribed involves the underwriter in purchasing the remaining shares at the minimum underwritten price, there is an incentive for these institutions to abstain from the bidding process and acquire the unsold shares at the low price (p46).

The case of Cable and Wireless lends some credence to this view.

TIME

The privatisation process not only incurs great expense but may also be very time consuming. Some months are required for the promotional campaign to be effective. Parliamentary debates and regulatory legislation are likely to turn the process into a marathon. The case of BAA serves as an example of the time involved. In total, four years elapsed from the declaration of the intention to sell to the sale itself. The list below summarises the time-table of events most of which are common to all privatisations (of the flotation type). This list is based upon Heath (1988).

1983 -

: June Upon the re-election of the Conservative party, the Queen's Speech alludes to the need to privatise airports where possible.

: August As requested, BAA submits its first memorandum on privatisation to the government.

: December An inquiry into British airports is begun by the House of Commons Transport Committee.

1984

: June BAA submits a second memorandum on privatisation.

: July The House of Commons Transport Committee's report is published in three volumes.

1985

: June The government publishes a White Paper on airport policy.

1986

: January An Airports Bill is presented and debated in both Houses of Parliament.

: July Airports Act 1986 receives Royal Assent. As set out by the Act, separate airports begin operation.

: August All of BAA's assets and liabilities are vested into BAA Plc.

: November The price regulation formula is announced.

1987

: June Eleven days after another Conservatives' election victory, BAA's pathfinder prospectus is published.

: July The full prospectus is published and the 245p fixed share price is revealed.

: July 16 Successful sale of shares (75% sold at fixed price; 25% tendered to the highest bidders).

: July 28 Trading begins in BAA Plc shares.

The four year privatisation process for BAA was not the longest in the UK. The privatisation of British Airways took a total of seven years.

IV PRIVATISATION TO DATE

This section of Chapter Three is a survey of Britain's privatisations. Divided into five sections the privatisation of individual State-owned enterprises is discussed. The five parts are Manufacturing, Communications, Energy, Transport and Services. In each case attention is focussed on one representative sale. More general notes then follow on other privatisations within that sector.

As has been noted before and as shall become clear again, British privatisations have involved a wide range of tactics and policies. No privatisation strictly copied another. Each contained features to overcome particular difficulties. Nevertheless, a pattern has emerged. The pattern and the experiences of the various privatisations are valuable when considering privatisation options for Ireland.

A reference point for the survey that follows is Table 3.1., located at the end of this chapter. In it the main British privatisations are presented alphabetically. The data for Table 3.1 has been collected from a number of sources including Neuberger (1987), Fraser (1988), Ramanadham (1988), Vickers and Yarrow (1988) and Veljanouski (1989) as well as company and newspaper reports.

THE MANUFACTURING SECTOR

The Case of British Steel

> Few debates in recent years have revealed more bitterness of feeling between the parties and none has helped to create a political situation more full of difficulties and dangers.

That was the view of The Economist in 1981 (17 Nov) about State ownership of the British steel industry. The history of British Steel Corporation (BSC) is an interesting starting point in this survey of privatisations. Steel has been nationalised twice and privatised just as often. Its history has paralleled the history of British politics. Its ownership has reflected the ruling ideology of the day.

Britain's varied and small steel companies consolidated in the 1930s to form the British Iron and Steel Federation (BISF) which later played a vital role in Britain's war efforts. Labour's 1945 election victory precipitated a wave of nationalisations few of which were based on sound economic sense. BISF, neither a loss-making nor a natural monopoly, was nationalised in 1951. The delay from 1945 was due to Labour's small majority and to the opposition of the BISF board. The vesting of the company cost around £300 million (Burk, 1988, p31). This comprised of compensation to its owners in the form of gilt-edged stock and the payment of BISF's liabilities. Whilst legislation was being prepared for the nationalisation, the BISF board and the opposition Conservative party made plans for BISF's immediate denationalisation upon the return to power of the Conservatives. This power change occurred in 1951 and the denationalisation plans were announced in the King's Speech. As before, changing the ownership of BISF was time consuming and divisive. The death of King George and the precedence given to denationalisation in the transport industry delayed the sale of BISF until 1953. The federation's estimated value of £180 million was based upon the price paid for it in 1951 and the profit retained since. The privatised steel company continued to be regulated by the Iron and Steel Board.

Labour's election victory of 1959 brought new plans for renationalisation. Again this was delayed until 1967 when the bulk steel-making sector of the industry was bought back by the government and renamed British Steel Corporation (BSC). This time the compensation value, based on average share prices was £568 million. Bryer, Brignal and Maunders (1982, p42) criticised this move because the bulk steel sector was a very poor investment prospect at the time. A continual fall in world demand for steel resulted in over capacity and a loss in profitability. Bryer *et al* argue that nationalising the whole industry was a necessary condition for the survival of the bulk sector. The new BSC made 131,000 workers redundant between 1967 and 1982 (Bryer, Brignal and Maunders, 1982, p3).

In 1973 BSC began an extensive capital investment programme in anticipation of a continual growth in world steel demand. Later in that decade world demand fell sharply and the optimistic investment programme was replaced by a dismal series of closures.

During the 1980s, and prior to privatisation, BSC embarked upon a comprehensive rationalisation programme. By cutting man hours per ton by 50% and employee numbers by a third, the company transformed a £1 billion loss in 1980 to a £400 million profit in 1987 (Aylen, 1988). The company sold £700 million worth of assets and property. Then in December 1987, with profits at £410 million, the government announced its intention to privatise BSC. One year later the sale was complete and the company was again in private hands.

BSC was privatised in November 1988. Its sale was the largest flotation of a UK industrial manufacturing company. It was, too, the first significant privatisation since the failed BP sale a year earlier. For these reasons the sale's marketing was thorough and elaborate. Based on a 'British Steel: British Strength' theme, the marketing campaign hit on the same senses of nationalism and pride as the BT promotion had done. Over 28,000 professional financial advisers were recruited to pass on information to their clients. Almost five million letters were sent to the shareholders in the UK's top 100 companies. (British Steel Share Information Office, 1988). Employees were offered free shares, matching shares and shares at a discount price. The government retained just one 'special' share, designed to prevent any one investor from holding over 15% of the company. The offer was three times oversubscribed. A large amount of shares were 'placed' with UK institutions. The flotation raised £1.8 billion (Annual Report, 1989).

After privatisation, profits continued to rise. In 1989/1990 they reached £733 million. This rise cannot be attributable to privatisation alone. The company's profit potential was well established before privatisation. Besides, in its latest accounts (1991/1992) profits collapsed to £55 million loss (Annual Report, 1991). The company has bought the UK's largest stockholding and distribution company, C Walker and Sons (Holdings) Ltd. It has also acquired companies in Germany and Spain. The current global recession and the collapse of the UK car and construction industries are tightening margins and will continue to test the privatised company. BSC recently closed the Ravenscraig plant in Scotland and shed 800 jobs in Scunthorpe. Yet the company remains one of the world's largest steel producers with a turnover exceeding £5 billion and a labour force of 56,000 (Annual Report 1991).

The Case of British Aerospace

British Aerospace (BAe) was privatised in two tranches in years 1981 and 1985, reducing the government's stake in the company from 100% to 48%, to 0% (except for one 'special' share). The aircraft and aerospace corporation had been nationalised as recently as 1977, together with ship-building. Both industries were included in the denationalisation plans of the Conservatives' 1979 election manifesto. The first issue of BAe shares was in February 1981 when 100 million, 150p shares were offered for sale. The offer, three times oversubscribed, raised £148 million. 58,000 employees applied for 33 free shares each and the matching shares available. £100 million of the revenue raised was re-invested into BAe.

The government's stake in the company was reduced to a 'special' share when almost 97 million ordinary shares, together with 50 million new shares were sold in May 1985 for 375p each. £550 million was raised by the sale of which £187 million was returned to BAe (Fraser, 1988, p22).

BAe's privatisation illustrates how the British government has been prepared to set a newly privatised company off to a good start. As well as buying Royal Ordnance from the government in 1987, BAe successfully bid for the Rover Group in 1988. Rover cost BAe £150 million but that price hid substantial sweeteners proffered by the government. Anxious to keep Rover (formerly British Leyland) British, the government sold its £1 billion worth of assets to BAe for £150 million. The government also wrote off Rover's £1,100 million tax debts and agreed to pay £800 million towards Rover's trade debts. This was later cut to £469 million by the European Commission.

A major constraint in the government's ability to freely choose a buyer was Rover's relationship with Japan's Honda. The two companies began collaborative projects in 1979 that included the production of the Triumph Acclaim. The government knew that Honda would end the relationship if Rover was sold to a rival (The Economist, 9 Dec, 1989, p41). The government had to choose a buyer who was British and was not in competition with Honda. BAe fitted the description and was coaxed into the purchase. The circumstances of the purchase, controversial at the time, became the subject of a major political row in 1990. In June of that year the EC Commissioner for Competition, Leon Brittan, ordered BAe to repay these sweeteners. BAe refused to do so because such a payment would not be "in the interest of shareholders" (BBC News, 26 July, 1990).

Apart from the Rover controversy, BAe is threatened (ironically) by the new superpower peace initiatives. The ending of the cold war and the democratisation of Eastern

Europe have reduced governments' demands for military aircraft and explosives. BAe owns Royal Ordnance, an explosives manufacturer. Since November 1990, BAe has shed 12,000 jobs as demand for its products collapsed (The Times, 13 Feb, 1992).

For BAe to survive it needs to develop its civil aircraft manufacturing and to diversify into consumer electronic goods. A sign of BAe's weakness was the disastrous £432 million rights issue in October 1991. The company also experienced a heavy fall in profits and the departure of senior management (Financial Times, 12 Feb, 1992). BAe made a pre-tax loss of £81 million in 1991 compared to a pre-tax profit of £376 million in 1990 (Financial Times, 20 Feb, 1992).

The Cases of The Rover Group and Jaguar

The British Leyland Motor Company (BLMC) was nationalised in 1975 and renamed British Leyland Ltd (BL). Until its sale in 1987, the government pumped several hundred million pounds into the company. By the time the company was renamed the Rover Group in 1986, a number of its subsidiaries had been sold including Jaguar. Discussions to sell the group itself to General Motors (1984) and Ford (1986) failed. The eventual buyer, for a much reduced fee, was BAe. The 1988 sale has since aroused much controversy (see above). With BAe as owner, Rover's collaboration with Honda has flourished. In 1991, however, Rover's losses reached £83 million falling from a pre-tax profit of £103 million in 1990 (Financial Times, 20 Feb, 1992). The losses reflected the general downturn in the British motor trade.

Jaguar, the luxury car maker, merged with the British Motor Company (later BLMC) in 1966 and was nationalised in 1975. In 1982 Jaguar Plc disbanded from the BL group to become a wholly owned subsidiary. This move was part of Jaguar's restructuring which had begun in 1980 as a result of Jaguar's slumped performance in the USA. Between 1980 and 1984, Jaguar's fortunes were reversed by exhaustive changes in quality, in technology, in the production process and in the dealer network (Hyman, 1988). Turnover grew from £160 million in 1980 to £746 million in 1985. The £121 million pre-tax profits bore no resemblance to the £47 million loss of 1980. Jaguar continued to grow as the US and British economies grew. And as these economies have slowed down in recent years, Jaguar's sales have suffered again. In 1988 Jaguar's pre-tax profits fell to £48 million from £87 million the previous year (Kompass, 1990). In 1989 Jaguar was bought by America's Ford, arousing criticism that State assets were being given away to foreigners.

The Case of Rolls Royce

The companies of Rolls and Royce merged in 1906 to later become the most prestigious luxury car manufacturer in the world. However, the company's aero-engine business failed to compete with Boeing and MacDonell Douglas. Rolls Royce went into liquidation in 1971 only to be rescued by the government. The government retained full control of the aero-business but sold off Rolls Royce Motors in 1973. Fifteen years later the Rolls Royce (Aerospace) company was successfully privatised. To aid the sale, the government wrote off over £600 million worth of company debts (Fraser, 1988, p47). Two million applications were received for the 801 million ordinary shares offered at the fixed price of 170p. The issue, more than nine times oversubscribed raised £1.3 billion. The costs of the sale were £14 million. Employees received the usual preferences and discounts. The government retained a £1 'special' share.

Since privatisation the company has suffered from the general downturn of the aerospace industry. Profits for the first half of 1991 were down 90% on the same period in 1990 (Financial Times, 21 Nov, 1991).

THE COMMUNICATIONS INDUSTRY

The Case of British Telecom

The sale of British Telecom (BT) was a watershed in Mrs Thatcher's privatisation plans. Its privatisation silenced those who believed that privatisation was a limited exercise. It seemed to prove Moore's (Financial Secretary to the Treasury) warning that "no monopoly was sacrosanct", (Moore, 1986). Due to its massive scale and huge success, and to its important role as a stimulus to other privatisations in Britain and around the world, the flotation of BT is given special attention here.

Deregulation was the initial stage in the privatisation process. The British Telecom Act of 1981 split the Post Office from telecommunications and created the British Telecom Corporation that would have to compete with a new rival, Mercury. BT retained the right to install a householder's first telephone but had to compete with Mercury for other business. In 1982 the government decided to raise funds for BT by the sale of so-called 'Busby Bonds'. These performance related bonds were in effect borrowings from the private sector. But this initiative was dropped within weeks in favour of privatisation. The government's PSBR constraints restricted BT's modernisation plans. The necessary capital would be more easily raised in the open market.

It was decided not to break up the corporation. Instead a new regulatory body, Office of Telecommunications (OFTEL) was set up to ensure competition. This is financed primarily by a levy on the licensees (BT and Mercury). Its functions are to deal with consumer complaints and to ensure that BT does not exploit its near monopoly position. OFTEL must also ensure that BT adheres to the **RPI - X** formula (Littlechild, 1983). The formula was designed to limit price increases in BT's non-competitive, domestic activities, including local and trunk calls and business lines. It does not cover international services or value-added services (e.g. appliances). The **X** of the formula was set at three. The formula applied to a basket of goods but there remained a wide scope for BT to vary the relative prices within the basket. A separate formula, **RPI + Y**, applies to price increases for residential line rentals. **Y** was set at two. These formulae were adopted instead of other regulatory ideas considered by OFTEL (Vickers and Yarrow, 1988, Ch8). These included:

i. Maximum rate of return for BT.
ii. Output related profits levy (i.e. more output, less tax).

Both of these were considered to be poor incentives. The **RPI - X** is designed to cut industry costs. The formula itself was seen to be temporary until real competition developed. To date real competition has not been realised and the formula remains.

The 1984 privatisation legislation ensured that the government would retain 49.8% of BT shares as well as a 'special' share providing the secretary of State for Trade and Industry with certain veto rights. That left £3.9 billion worth of shares for sale (Newman, 1986, p41). The government was especially keen to sell shares to as wide a group as possible including foreign interests. Three markets emerged. These were the UK financial institutions, the British public (including BT employees) and foreign investors. In the outturn the respective allocations were 47%, 39% and 14%. 95% of BT employees (around 220,000) applied for shares (Wiltshire, 1987, p50).

The government and British Telecom embarked upon a most ambitious promotional campaign, discussed above in Section III. The 3,012 million ordinary shares of 25p face value were offered for sale at 130p each, payable in instalments of 50p upon application, 40p in June 1985 and 40p in April 1986. The issue was the biggest ever, anywhere. It was underwritten by fifteen underwriters headed by Kleinwort Benson Ltd (who later underwrote the privatisation of the Electricity Supply Industry) and Warburg (Newman, 1986, p108). The 130p shares valued the company at £7,830 million. £3,916 million of the company was offered for sale in November 1984. The offer was heavily oversubscribed as more than £16,500 million chased the available shares. In the allocation of shares the small investor was favoured. The allocation was as follows:

Those applying for :	200-400	shares got what they sought
	800	shares got 500
	1,200	shares got 600
	1,600-100,000	shares got 800
	over 100,000	shares got none at all. (Newman, 1986, p167)

This one issue doubled the number of shareholders in the UK. They were rewarded with a 40p premium on the 50p partly-paid shares on the first day of trading. The flotation was seen as hugely popular and successful despite criticism of under-pricing. When all the instalments were paid the sale had raised £3.9 billion more than twice the £1.4 billion raised by the whole of the private sector in 1984 through new ordinary share sales (Mayer and Meadowcroft, 1985). This quietened critics who did not believe that such a sale was possible. It was possible and showed that no State-owned enterprise could assume immunity from privatisation.

The government's goal to increase the number of small shareholders was clearly achieved by the privatisation of BT but its other goals were less successful. The effectiveness of the competition between BT and Mercury has been questioned. It has been widely noted that a duopoly holds the seeds of collusion (Veljanouski, 1989, p28). Allowing

Mercury to be BT's sole rival is only partly liberalising the industry. The government has mistaken duopoly for effective competition. The competition between BT and Mercury depends on the interconnection between their services. To assist competition OFTEL instructed BT to supply interconnection facilities to Mercury at a preferential cost. BT and Mercury are faced with competition in the manufacture of equipment and in the cable and cellular services. Technology facilitates competition in the whole industry but the government will not introduce it.

BT's first AGM following privatisation was held in August 1985. Thousands of BT's small investors attended to hear that pre-tax profits had increased 49% on the 1984 figures to £1.5 billion from a turnover of £7.65 billion (The Economist, 12 Sept, 1985, pp91/92). During 1985, BT bought the Canadian Mitel Corporation, manufacturers of private automatic exchange equipment. The acquisition cost £160 million .

BT has continued to perform well. In the half-year until 30 September, 1989, BT's turnover, earnings per share and capital invested all swelled (The Irish Times, Nov 17, 1989). Its pre-tax profits for year ending March 1990 exceeded £3 billion. This huge profit attracted widespread criticism that shareholders were benefiting at the expense of consumers. BT denied that the profits were excessive.

They said they achieved the profits through efficient management and productive techniques and despite widespread price cuts. BT's workforce has been cut from 241,000 in 1984 to 223,000 in 1991 (Evening Standard, 8 Aug, 1991). Profits for 1990/1991 and 1991/1992 were flat, having been constrained by recession, increased competition and a tighter price formula where X is now set at 6.25% (Financial Times, 31 Jan, 1992).

The growth in BT's profits is not a reliable measure of an improvement in efficiency. Profits may have grown as a result of exploiting its quasi-monopoly power. Complaints about BT's services and user charges have also increased. The survey by Foreman-Peck and Manning (1988) shows no evidence that BT has performed any better than its State-owned monopolistic counterparts in continental Europe. The **RPI - X** price formula has been enforced but as it is only an average formula it fails to safeguard against charge rises for specific services. The competition offered by Mercury has not been effective. Although Mercury's sales have grown and profits risen, these were achieved in niche sectors. By introducing massive charges for connection fees, BT has crowded out the Mercury competition. Further deregulation of telecommunications is likely. The telephone market may be split into three sectors: international, long-distance and local. Any private licenced company will be allowed to compete in any or all of these sectors (The

Economist, 17 Nov, 1990).

The government sold part of its remaining 49% stake in BT in 1991. The Financial Times (24 June, 1991) reported that advisers urged the government to sell the shares without fixing a price. That is, it should sell at a fixed discount. In the end the government chose the well tried fixed price sale, combined with a global tender offer of one third of the issue for financial institutions. £5.35 billion worth of shares were sold at 305p for small investors and 350p for institutional investors. All shares were payable in three instalments. The offer was 2.5 times oversubscribed (The Times, 9 Dec, 1991). On the first day of trading in the new shares, a small premium of 15p was available (The Times, 10 Dec, 1991). The government made a huge saving by not underwriting the issue. This was unnecessary because of the strong institutional bidding for the tender offers.

<u>The Case of Cable and Wireless</u>

The decision to privatise the radio, cable and telegraph communications company, Cable and Wireless, was announced in 1980 and the power to do so was contained in the British Telecommunications Act, 1981. In October of that year, just over 49% of the company was sold at 168p per share, raising 1189 million for the government and £35 million for Cable and Wireless. When the company purchased the Hong Kong Telegraph Co. in 1983 the government's holding was reduced to 45% (Fraser, 1988, p24). This was reduced to a single 'special' share following two further share sales. Roughly half of the government's holding was sold in December 1983 after an offer of sale by tender (minimum price was 275p). £260 million were raised. All but the 'special' £1 share of the government's holding was sold in December 1985 at the fixed price of 587p per share, raising a further £933 million.

In 1984 Cable and Wireless took full control of Mercury Cummunications. Since privatisation the profit of Cable and Wireless increased seven-fold (Ramanadham, 1988, p107). In 1990 group profits reached £609 million, greatly helped by a 76% jump in Mercury's profits (<u>Financial Times</u>, 13 June, 1991). Profits for 1991 were £644 million aided again by a large rise in Mercury's profits. A survey by Game (1987) revealed that by 1987 only 20% of the workforce given shares in 1981 had sold them. Two thirds of the respondents to the survey approved of the privatisation of their company.

The privatisation of Cable and Wireless is a remarkable lesson for Ireland of how revenue can be maximised by selling a company in tranches. Had the whole company been sold in one go in 1981 at the fixed price of 168p per share the revenue raised would have been only £386 million. By selling the company in tranches over a number of years and by using both fixed price and tender offer methods of sale the privatisation of Cable and Wireless raised £1,382 million. The sale is one of the great successes of the UK's privatisation programme. But it failed to achieve at least one of the government's objectives. The number of small shareholders (non-employees), initially 150,000, fell to 26,000 within a year. In 1990 Lord Young was controversially appointed to the board of Cable and Wireless. Lord Young was the minister responsible for the company's initial flotation.

THE ENERGY INDUSTRY

The Case of British Gas

The British Gas Company (BGC) buys gas from the oil companies, transmits it throughout Britain, sells it to households, companies etc., and services the transmission network. The exploration for the gas is left to the oil companies with whom BGC has long-term contracts. The transmission network is divided into twelve regions but, nationally, BGC ensures that demand equals supply. When there is low demand the excess gas, whose supply is fixed in the short-term, is stored only to be used when demand is high.

In 1986 BGC became the second utility to be privatised (after BT) following fierce resistance from its board. The Gas Act of that year transferred all of the assets of BGC to a new company, British Gas Plc. The company was sold in December 1986 for over £5 billion making it the then biggest flotation ever. The government continues to receive proceeds from the sale until 1991 because British Gas Plc was required to issue £2.5 billion worth of debentures to the government (Vickers and Yarrow, 1988, Ch9). The issue was four times oversubscribed as more than five million applicants sought the four billion shares on offer. The issue was scaled down so that those seeking more than 500 shares received less than they sought. Employees of the company received preferential treatment including free shares and a 'two more shares for each one bought' deal. This attracted 99% of the employees. The costs of the sale included £70 million for advertising and £11.5 million for underwriting. To this may be added the £220 million cost of the 'loyalty bonus' scheme whereby shareholders who kept shares for a long period received discounts on their gas bills (Veljanouski, 1987, p108).

Unlike the BT sale, the government did not retain a sizeable share in British Gas Plc. Instead only a 'special' share was withheld to enable the government to veto decisions should the need arise. The regulation of the new British Gas Plc closely mirrored that of BT. Based on OFTEL, the government created the Office of Gas Supply (OFGAS) headed by a Director General of Gas Supply. The roles appointed to OFGAS include monitoring consumer complaints, overseeing R&D granting licences to other suppliers of gas and fixing the maximum charges. Charges are governed by an **RPI - X** type formula. In 1991 **X**, was set at 5 for the period 1992-1997 (The Economist 15 June, 1991, p30/35). Since privatisation, gas domestic tariffs have fallen but for heavy industrial users British gas remains among the costliest in Europe.

While the sale of British Gas may be seen as another milestone in the British privatisation programme, it did little to quieten opponents. As before, the 135p shares (payable in instalments) seemed to have been under-priced. The premium available on the first day of share trading was 20p per share, suggesting that the company was under-valued by £800 million. Costs were excessively high. Even more so than BT, British Gas Plc had been transferred to the private sector "with its monopoly and monopsony powers intact"

(Vickers and Yarrow, 1988, p267). Although the government benefited from the £5.4 billion raised the consumer did not benefit from any increased competition. The company's monopoly position has allowed it to sustain yearly pre-tax profits of almost 1 billion (Kompass, 1990). Profits for 1991 exceeded £0.9 billion (Annual Report, 1991).

<u>The Case of British Petroleum</u>

The case of BP is among the most interesting. Labour governments have been traditionally opposed to privatisation but in 1977 Wilson's cabinet decided to sell shares in BP in order to reduce the PSBR. £564 million was raised by the sale which reduced the combined government and Bank of England holding from 68% to 51% (Fraser, 1988, p52). Shares, priced at 845p each, were not aimed at the general public. A further sale of the government's holding of BP was among the first actions of Mrs Thatcher's 1979 administration. A little over 5% of BP was sold at 363p per share raising £276 million for the government. In 1983 the government / Bank of England stake in the company fell to 32% following another sale of 1.3 million BP shares. These were sold at 435p each, raisng another £543 million.

By 1987, the BP group was UK's largest and Europe's second largest company (after Shell). The decision of BP's board to issue new ordinary shares prompted the government to simultaneously sell its remaining share of the company. The time seemed right to exploit the extraordinarily bullish market of that year. The share price was set at 330p, payable in instalments of 120p, 105p and 105p. But the offer, along with the bullish market, collapsed. The blackness of Monday, 19 October, 1987 greatly darkened the government's and the public's views of privatisation. Only 3% of the offer was subscribed as 1.2 billion shares were taken up by the underwriters. These professionals claimed that such a crash (FT Index fell by 28%) made their contract with the government void. To avoid further chaos in the market-place the protests of the underwriters were placated by the government's offer to buy back the 120p partly-paid shares for 70p each. That was roughly the price at which the shares subsequently traded. Nevertheless, the issue raised £7,200 million, £1,500 million of which went directly to BP. Of the government's £5.7 billion, £109 million covered the cost of placating the underwriters (Fraser, 1988, p53). The other costs of the sale were around £200 million.

Some months after the final stage of BP's privatisation, the company made a dawn raid on Britoil, itself privatised in 1982-1984 (see below). It also bought America's Standard Oil. BP reported a profit of £1.6 billion for 1990. This fell to just £415 million for 1991 (Annual Report 1991).

BP has become the third biggest company in the world exceeded only by Exxon and Shell. In 1990 it embarked upon a restructuring project, code named 'Project '90' ('Money Programme', BBC Television, 20 May, 1990). It is aiming to cut jobs and to regain the speed and agility of a small company. Paper work is being pruned and emphasis is towards teamwork. Its logos and its image are turning green. In the USA the company's six trading names (Sohro, BP, Gulf etc.) will soon be collectively known as BP. The company's new leader, Robert Horton sees this restructuring as presenting a real chance for BP to become the most successful oil company in the world. Arguably, it has been privatisation that has given BP the will and the ability to achieve this goal. The wider access to investment funds facilitated BP's drive to meet the demands of shareholders.

The Case of Britoil (BNOC)

The British National Oil Corporation was set up in 1975 to produce, refine, store and distribute the newly discovered North Sea oil. It oversaw all activities in the British waters of the North Sea. It was, in effect, a government department of oil and petroleum. The new Conservative Government of 1979, anxious to reduce the PSBR, required the BNOC to forward sell oil (that is, receive payment now, produce later). These payments to the government amounted to £620 million in 1979-1980 (Fraser, 1988, p28) but netted out to a zero figure in the years that followed as the sale contracts were honoured.

In 1982 BNOC's exploration and production functions were afforded to the newly formed Britoil, 51% of which was to be sold to the public. The BNOC board had unsuccessfully fought against this move. The sale took place in November 1982. 255 million shares were offered for tender. Employees received preferential rates. A minimum tender price of 215p was set. The price turned out to be ill-judged. The offer was grossly undersubscribed and the underwriters had to buy 185 million unsold shares. Nevertheless the government earned £548 million from the sale and received a debenture payment of £88 million from Britoil.

The government sold its remaining stake (except its 'special' share) in Britoil in 1985. This time the share price was fixed carefully at 185p. The offer was comfortably oversubscribed and netted £462 million for the government.

Britoil was bought in stages by BP during 1987 and 1988. The government did not use its 'special' share to veto the purchase. BNOC was itself dissolved in 1986, its remaining functions having been transferred to a new Oil and Pipelines Agency.

The Case of Enterprise Oil

The uncertain nature of the energy industry and of the oil industry in particular, was reflected in the undersubscription of BP (1987) and Britoil (1982) shares.

Enterprise Oil, formed in 1982 and sold in 1984, did not break from the pattern. It, too, was undersubscribed and underwriters were left with 33% of the available 185p fixed price shares. The government received £380 million from the sale and retained only a single 'special' share (Veljanouski, 1987, p5).

THE TRANSPORT INDUSTRY

The Case of British Airports Authority

Like BT, BAA has evolved from a department of the government (until 1965), to a public corporation regulated by long-run marginal cost pricing, to a public limited company (in 1986) fully owned by the State, to a privately owned company. Prior to privatisation in 1987, considerable regulation and restructuring were required for the company (now officially called BAA and not British Airports Authority).

The public corporation had consisted of 35 commercial airports of which seven dominated. In the South-East Network were Heathrow, Gatwick and Stansted. The Scottish Network consisted of Glasgow, Edinburgh, Prestwick and Aberdeen. The government decided to sell BAA as a group rather than sell the networks separately or sell the airports individually. This tactic, as it had often done before, maximised revenue but did little to increase competition. In recognition of this the government devised a new regulatory system (Heath, 1988). The airports' customers were 200 airlines and 55 million passengers. It was decided that only airport charges in the south-east would require an **RPI - X** price regulation. **X** was set at one. Of course the new BAA Plc would remain within the trading jurisdiction of the Civil Aviation Authority (CAA) and of the Secretary of State for Transport (who distributes air traffic routes among airports).

The flotation of BAA was a combination of fixed price and tender offers. 375 million shares were offered at a fixed 245p price; 125 million were auctioned at a minimum tender price of 282p. Employees received free shares along with two-for-one matching shares. The offer, several times oversubscribed, raised £1,284 million for the government and nothing for BAA Plc. 98% of employees bought shares. The costs of the sale exceeded £70 million (Heath, 1988). The sale's time-scale was epic. The four year saga from the intention to sell in 1983 to the first days trading in BAA shares in 1987 has been recorded already in this chapter.

In 1991 the CAA, the aviation regulator, decided to keep **X** at 1 in the **RPI - X** price formula. By March 1991, most traffic distribution rules were dropped and Prestwick's monopoly on transatlantic flights was ended (Annual Report, 1990/1991). The loss of intra-EC duty-free business will cost the company about £50 million a year. To overcome this the company plans to open a network of VAT-free superstores in its major airports. Its partner in this scheme will be Marks and Spencers (Financial Times, 18 June, 1991). The Economist (15 June, 1991, pp30-35) said that three main airports, Stansted, Gatwick and Heathrow should be disengaged and allowed to compete. The MMC will produce a full report on BAA in the near future.

The sale of airports is politically sensitive. Great care has to be taken to ensure that private airports are competent in combatting smuggling and other criminal and subversive activities. Private or not, airports must honour international agreements on pollution (noise etc.) and safety procedures, as well as air traffic control.

The Case of British Airways

The privatisation of BA shares a number of similarities with that of BAA. The relationship between the two companies is similar to that between Aer Lingus and Aer Rianta, although more distant. The timespan of BA's privatisation was even longer (seven years) than that of BAA (four years). BA's sale, too, was heavily (32 times) oversubscribed. And like BAA Plc, the private BA remains largely a monopoly on certain routes.

The pre-privatisation financial restructuring of BA was discussed in Chapter One of this study. There it was noted that the 1981/1982 accounts had to digest the full costs of

£199 million for the reduction of employee numbers from 58,000 to 35,000 during 1979-1983. Those same accounts had also to include the £208 million cost of decreasing the aircraft's depreciation period from sixteen to ten years (Whitfield, 1983, p37). The accounts for the years that followed were, therefore, trim and attractive. To be sure of the privatisation's success the government wrote off BA's £1 billion debt.

Seven years after the intention to privatise BA was expressed in the Civil Aviation Act 1980, the company was sold. The privatisation sale date was postponed six times over that period (Campbell-Smith, 1986, pp311-315). The issue raised £892 million for the government. BA has since sold many of its subsidiaries and has kept the revenue for itself. Company pre-tax profits have grown £162 million for the year of privatisation to £268 million for the year ending March 1989 (Annual Report, 1989). In June 1990 the company announced its intention to buy several multi-million pound jets, the engines of which are made by Rolls Royce (privatised in 1987), itself owned by BAe (privatised in 1981-1985). Profits for 1990/1991 fell to below £100 million due to the effects of the Gulf War and British recession. In July 1991 the chairman of BA threatened to stop the company's donation to the Conservative Party if the government proceeds to further deregulate the industry.

The Case of Associated British Ports

The Transport Act 1981 renamed British Transport Docks Board, Associated British Ports (ABP). Its role remained to operate 19 ports around Britain. Just over half of the company was sold in February 1983 at a fixed price of 112p per share. The issue raised £22 million for the government, having been 34 times oversubscribed (Fraser, 1988, p32). ABP repaid a further £25 million worth of tax debts to the government. The government wrote off £88 million of the company's debts prior to privatisation (Hyman, 1988). In the fiscal year that followed privatisation, the company's pre-tax profits were £21 million out of a revenue of £138 million (Vickers and Yarrow, 1988, Ch6).

The sale's success changed the government's earlier decision not to sell its remaining 48.5% stake in the company. In April 1984 over four million 270p shares were sold, netting £51 million. The government retained no stake in the company. For the year ending March 1988, ABP made a pre-tax profit of £46 million from a turnover of £211 million (Kompass, 1990).

The Case of the National Freight Corporation

As a result of the Transport Act 1980 the National Freight Corporation was bought by its staff and management for £58 million. The government transferred £48 million of this back into the company's pension fund. The company was, therefore, virtually given away. Indeed the true cost to the tax-payer was considerable because, prior to its sale, the government wrote off £100 million of the company's debts (Hyman, 1988). The privatised company transformed a 1981 loss of £4.4 million to a 1990 profit of £39 million (Annual Report, 1989).

The Case of the National Bus Company

It took many years for the 78 subsidiaries of the National Bus Company to be sold. As has been already noted in this chapter, 38 subsidiaries were sold to management or staff, 24 were sold directly to private companies, and others were sold using a combination of these methods. One, Victoria Coach Station, was sold to London Regional Transport, a public body.

Bus services have been frequently deregulated since 1980. There have been spectacular price cuts in long distance coach travel. The leader in this area, National Bus Co. continues to dominate. It inherited the established, national network of routes and stations.

THE SERVICES INDUSTRY

Privatisation in the form of franchising and contracting-out has occurred throughout the services industry. While departments have not been sold off, many have contracted out some of their duties. Examples of these are explored below. The section begins with a clear, though not a typical, privatisation.

The Case of the Trustee Savings Bank

The TSB, with around 1,600 branches, is the largest personal financial services group in Britain (Veljanouski, 1987, p122). When the government decided to privatise the group, controversy arouse over its ownership. The Crown courts were unsure if ownership lay in the hands of the government, of the group's employees or of the banks' depositors. The House of Lords declared that the government owned the group and were entitled to any revenue raised by its sale. By then, the government had decided to allow the TSB Group to retain the profits from the sale. In the end the widely advertised issue was several times oversubscribed and raised £1.3 billion. Applicants seeking over 10,000 shares received none at all. In this way the institutional investors were snubbed (The Economist, 4 Oct, 1986, p82). The TSB retained all the proceeds as well as the group's £800 million worth of assets (Neuberger, 1987, p32). This privatisation was the greatest single give-away. The 100p share rose to 177p on its first day of trading (Veljanouski, 1987, p94). In 1987, a year after the privatisation, the TSB Group Plc bought the merchant bank giant, Hill Samuel for £777 million. It was the disastrous performance of Hill Samuel that caused the TSB's £150 million loss for the year ending April 30, 1991 (Evening Standard, 27 June, 1991). It is clear from this case that the privatisation did not safeguard against poor investment decisions by management.

More generally, UK banking has been widely deregulated reflecting a worldwide trend (Kay and Vickers, 1988). New technology is producing more financial products.

Liberalisation is allowing these products to be traded freely. It is not uncommon for non-banking agencies such as building societies to offer traditional banking facilities. Similarly, banks are developing their range of mortgage and investment products. Banks are becoming "deal makers rather than loan makers" (Mullineaux, 1987, p22). The EC's plans for post-1992 Europe include a freer movement of money and more open competition in financial services.

Liberalisation is increasing competition and reducing profit margins. In reply, banks are having to offer more products. Advanced technology is allowing this to happen. In the US, meanwhile, there is a trend back towards re-regulation following the Johnson Matthey Bankers collapse in 1984, the Savings and Loans debacle of 1990 (In July of 1990 it was estimated that the S & L frauds may cost the federal government over $175 billion [NBC News, 5 July, 1990]) and the BCCI closure in July 1991.

<u>The Case of The Electricity Supply Industry</u>

On 31 March, 1990 Britain began a series of privatisations in the electricity supply industry (ESI). The electricity supply industries of several European countries and of the USA were already in private hands. The sale of the British ESI involved not only a complicated series of flotations but an entire reform of its structure.

Before privatisation, the ESI was structured around the Central Grid which was owned and managed by the Central Electricity Generation Board (CEGB), a central monopoly. The grid supplied electricity to twelve areas boards in England and Wales (as well as to Scotland and France). The area boards, each a regional monopoly, supplied electricity to the consumer. The Electricity Council coordinated operations and pursued research and development.

The 1989 Electricity Act set the plans for privatisation. The CEGB was to split into two generating companies: Gen 1, responsible for 70% of output including nuclear energy; Gen 2, responsible for 30% of output. In the end the government decided to retain nuclear power within the public sector as it feared it would jeopardize the whole sale. Gen 1 became

National Power with 52% of capacity and Gen 2 became Power Gen with 30% of capacity. These two generating companies now compete in selling to the twelve area boards which have been renamed Regional Electricity Companies (RECs) and were privatised separately. The regional companies can negotiate directly with power stations for the cheapest electricity and the best terms. They can also buy electricity from small local suppliers or supply their own (Bailey, 1988). Between the two generating companies and the RECs lies the National Grid Co (NGC), owned jointly by the RECs. Its job is to manage the power pool, to distribute electricity to the boards and to operate the interconnection with France and Scotland.

There remains throughout the system several monopolies, although fragmented and regional. For this reason a competent regulatory regime is necessary. The Office of Electricity Regulation (OFFER) is responsible for this superintending. Its director, Littlechild, based the price regulation on the now widely adopted **RPI - X** formula which he designed for British Telecom. In the case of the ESI there are three important formulae (Vickers and Yarrow, 1991 and Regional Electricity Companies, 1990). The transmission charges for the National Grid Co. is restricted by an **RPI - X** formula where **X** = zero for now. The RECs are subject to distribution charges whose price cannot increase further than **PRI + X** where **X** = 0...2.5 and differs for each company.

The consumer is charged according to his use of electricity. There are price controls for charges to large industrial users. For small users, charge increases cannot exceed **RPI - X + Y**, where **X** = Zero and **Y** = 0...infinity (depending on the distribution charge in the previous stage). The **Y** factor allows the costs incurred in the purchase and delivery of electricity to be passed on to consumers.

The duopoly in the electricity industry that now exists leaves a danger that National Power and PowerGen may collude. The distribution of electricity has been deregulated so that other private firms may compete with the RECs to supply larger users of electricity. But the vast majority of consumers still have no choice over which company distributes electricity to them.

In December 1990, 100% of the ordinary share capital of each of the RECs was offered for sale, of which 20% was for foreign investors. At 240p per share the minimum investment was £240 payable in three instalments. Consumers and employees who retain their shares for a long period were offered a choice of extra shares or electricity vouchers (Regional Electricity Companies, 1990). The government retained a share in each REC and in the NGC. The sale of the RECs raised £5.2 billion having been over ten times oversubscribed. The 5.2 million investors enjoyed a first day premium of 66% (The Economist, 15 Dec, 1990, p106). In many cases the number of small investors soon fell. Within one year the number of shareholders in London Electricity fell from 1,000,000 to 340,000. Southern Electricity lost 700,000 of its 1,200,000 shareholders in the same period. (Evening Standard, 27 June, 1991).

Robinson (1989) says that the sale of the electricity supply industry requires a re-examination of the government's industrial policy. For years the industry has been used to aid other national public enterprises. It buys 75% of British Coal's output. It has sold cheap electricity to British Steel and others. The privatisation of the ESI is not, according to Robinson, an end in itself but a necessary step towards a privatisation of the coal industry.

In June 1991 the two Scottish electricity companies, Hydro Electricity and Scottish Power were privatised. Almost 10% of Scotland's population applied for shares. The sales raised £3 billion. Four Northern Irish power stations will be sold off soon (House of Commons Debates, 1991, p733w). During 1991 the RECs of England and Wales reported flat profits. National Power and Powergen reported rises in operating profits of 15% and 24%, respectively (Financial Times, 27 Nov, 1991). National powers profits rose a further 18% for 1991/1992 to reach £514 million. On report of the profits, the company also announced that 3,000 jobs will be cut (The Times, 6 June, 1992).

The Case of The Water Industry

Prior to the privatisation of the water industry the government wrote off £4.6 billion of the industry's debts and invested a 'green dowry' of £1 billion to help the companies begin modernisation schemes (Accountancy, 1989, p82). The Water Act 1989, that provided for the privatisation programme, requires the twelve newly privatised companies to supply 'wholesome' water. As a result of privatisation in 1990, ten water and sewage companies and 26 water only companies became privately owned. All remain local monopolies. The industry is now regulated by the Office of Water Services (OFWAT). This office regulates the price of water, the sale of company assets and the diversification of the companies. The price regulation is based on an **RPI + K** framework. This is an average price limit for a basket of charges. Individual charges can be raised by more than **RPI + K**. **K** is set differently for each company and varied for 1990/1991 from 3 to 22.5 (OFWAT, Annual Report, 1990). Half of the retention on land sales must be passed on to consumers by way of reduced prices. The firms are free to diversify provided the core water business is unaffected.

The privatisation of the ten water companies in England and Wales raised £3.6 billion. The net revenue raised was low because the government gave the companies a cash injection of £1.5 billion (The Times, 17 Feb, 1992).

All of the water companies recorded significant profits in their first year of trading. The water companies argue ('Money Programme', BBC2, 12 May, 1991) that the high value of **K** is necessary to finance huge investment programmes (estimated to total £28 billion by the year 2000 [The Times, 3 Dec, 1991]). OFWAT agrees but reminds them that **RPI + K** is a maximum price increase allowed, not a recommended one. While consumers can understand the need for investment they may be perturbed by the water companies' increasing diversification. Several companies are using consumers' money to invest in other companies so as to increase profits and/or share prices for the gain of shareholders, an elite group. In light of this, the water charges may be seen as a regressive tax going towards the fortunes of the better off. OFWAT predicts that the average household water bill will rise by almost 50% during the 1990s (OFWAT Annual Report, 1990).

Housing

In 1980 the Thatcher government oversaw the sale of over 750,000 local authority houses to tenants. Simultaneously English 'New Towns' disposed of £1,000 million worth of industrial and commercial property. Gains from the sale of local authority housing during the 1980s were greater than the revenue from all other cases of privatisation (Harrison, 1989, p45). The net gain is less than this when mortgage interest tax relief is taken into account.

Government Services

Privatisation has occurred throughout central and local government and the National Health Service (NHS). In most cases this took the form of contracting-out, introducing charges or issuing vouchers. Disinvestment has also occurred including the sale of Royal Ordnance to the privatised BAe.

This study has already recorded that by 1986 76% of laundry, 82% of maintenance and 84% of cleaning services within central government in the UK were contracted-out to private business. The Local Government Acts of the 1980s increasingly forced local government to contract-out many services. The Local Government Act 1988, for example, extended compulsory tendering to the catering, refuse collection, vehicle maintenance, grounds maintenance and cleaning activities of local authorities (Rawlinson and Tanner, 1989, p62). Similarly, ancilliary services of the NHS must be open to competitive tendering. However, Ascher's study (1987, Ch3) reveals that by 1987 the penetration of contracting-out into central and local government as a whole remained low.

Voucher schemes have been introduced into the ophthal-mological services of the NHS and into the education service. Their success have been mixed.

Local government significantly raised housing and transport charges and introduced new charges for services such as planning permission.

Central government also looked for ways of off-loading financial commitments. Services such as driving tests raised charges. Universities were forced to turn to the private sector for funding for new investments. Museums introduced charges. Rose records (1990) that in 1990 revenue raised by charges paid for 7.1% of the education and science budget and 7.9% and 4.7% of the defence and the health budgets. The government plans to privatise the Fisheries Protection Service and to allow private security firms to tender for contracts to run prisons.

Competition has been introduced in the education sector. The Education Reform Act, 1988 allowed schools to opt-out of local authority control. A majority vote by parents can allow the school to become centrally funded and grant maintained. In 1991 competition among British schools was increased by the publication of statistics on school's success rates in State exams. Parents were encouraged to choose the school with the 'best' results. These crude statistics made no allowance for the socio-economic backround of the pupils in each school. (A similar proposal is contained in the Irish government's current Green Paper on Education.) A further withdrawal of State aid for education was the replacing of third level student grants with loans. In effect, part of the cost of further education was privatised in that State investment was replaced by the students' own future incomes.

FUTURE SALES

Following the re-election of the Conservatives for a fourth consecutive term, the privatisation programme is likely to continue. Three industries are likely to be privatised slowly and with great care. The three probable targets are the Coal Industry, The Post Office and British Rail. Each sale will be as great a challenge as any confronted in the 1980s.

It is difficult to surmise how these industries may be privatised. If the pattern of the 1980s is to be maintained, each of the industries will be sold as a whole through a share flotation.

The Coal industry may be broken up into coal production and processing. Open-cast mines, the most profitable, may be sold separately and first. Area boards could be sold independently in the same way as the Regional Electricity Companies. The privatisation of the ESI may become the most important step in the preparation for the privatisation of the Coal Industry. The ESI is by far the National Coal Board's largest buyer but is now free to buy fuel of any kind from any source. British Coal, publicly or privately owned, needs to be very efficient to hold on to this vital customer. Before privatisation, a thorough deregulation of the coal industry will be required. British Coal's monopoly is unjustifiable. Competition is restricted because new entrants require a licence from, and must pay a royalty to, British Coal itself.

The Post Office is one of the oldest State-owned enterprises. But it is not a 'natural' monopoly. Greater competition could be introduced into the collecting, sorting and delivery of the mail. Plans to privatise the Post Office in 1987 were dismissed by Mrs Thatcher who was reportedly opposed to the sale of a company whose logos bear the royal arms (The Economist, 15 Dec, 1990, p34). To date competition is only evident in the parcels division which is its greatest loss making sector. One difficulty with the privatisation of the Post Office is separating its roles as a social service and as a commercial service. A break up of the Post Office is the likely way forward. Parcels and express delivery already compete vigorously in the market-place. They could be the first to be sold. The greatest revenue potential for the government is the sale of the Post Office real estate. Post Office buildings are situated throughout the country and often in prime retail areas.

British Rail (BR) is a natural monopoly. That is, average cost falls as more trains run on the one line. If competition is to be introduced, how is it to be achieved? It is not feasible for rival companies to have rival tracks. Competition will have to be in train services, running on a common line, rather like the competition between BT and Mercury. Train companies may share facilities such as stations and signals just as airlines share airports. At present BR is divided into five main trading sectors. The profitable ones are Intercity, Rail Frieght and Parcels. The loss making sectors are Network South-East and Provincial. As a group, BR suffered a £144 million loss for 1991/1992.

The current 'Organisation for Quality' programme allows the five sectors to function as autonomous companies. From a sale point of view, a sector sell-off may be the simplest option. After privatisation, the integration of these sectors and their charges could cause many difficulties. From a revenue point of view, the most attractive prospect is selling BR's huge basket of real estate. In 1984 BR's Transport hotels, Sealink and catering division, Travellers' Fare, were sold. BR Engineering has also been sold. During the period, 1989 to 1990, over £600 million worth of BR property was sold (The Economist, 15 Sept, 1990, p43).

The government is planning a White Paper on British Rail. This is expected to propose an end to BR's monopoly by allowing private firms to compete directly for business. These firms will be allowed to use the existing infrastructure and railways like competitors of BT and British Gas use their existing cable and pipe networks. The White Paper is also expected to propose some sort of a privatisation of the ownership of BR ('Money Programme', BBC2, 2 Feb, 1992). Arguments against BR's privatisation include the fear that the fragmentation of the system will reduce the quality of the services. A fragmented system may be operationally chaotic. Trade unions are likely to oppose BR's flotation with the knowledge that the privatisation of Japan's railway resulted in the loss of 62,000 jobs (Salveson, 1989, p83). Furthermore, any privatisation legislation will need to explore the effects on regional industrial policy and on the Channel Tunnel.

These future privatisations are only speculation. The Labour party has stated that, if returned to power, it will buy back majority stakes in BT, British Gas and others. Such renationalisation may prove to be a more difficult task than the privatisations of the 1980s.

V ASSESSMENT

This section of Chapter Three assesses Britain's privatisation programme of the 1980s. It attempts to view the good as well as the bad with the benefit of hindsight. It is necessary to examine the circumstances, political and economic, pervading during the different stages of the programme. The economic significance and achievements of privatisation cannot be easily divorced from the political philosophy upon which it is based.

Politically, privatisation has been hugely successful. It assisted Mrs Thatcher to win three successive general elections. Privatisation has helped to create a society more aware of the value of personal enterprise and endeavour. Politically, privatisation has isolated the Labour Party, forcing it to review its policy on state-ownership and centralisation. The multitudes of small investors and eager entrepreneurs could support only the Conservative Party, the one that clearly preached their philosophy of self advancement.

As the decade closed difficulties emerged. The old 'British Disease' of inflation, stagnation and recession reappeared. The Conservative Party's economic miracle had produced a legacy remarkably like the feared offspring of the old economic order that the 1980s were thought to have destroyed.

By 1990 the problems were clear, yet support for Thatcherism and privatisation had not disappeared. Desperate monetary fine tuning was employed in an attempt to withstand the threatening economic and political downfall. Privatisation continued to have a role to play. The water and electricity supply industries were privatised. Recently, a tranche of BT shares has been successfully sold. Studies are being prepared on the privatisation options of the three remaining giant public companies, BR, British Coal and the Post Office.

This assessment considers the economic success of privatisation. The verdict is largely indecisive. The privatisation programme of the last decade has been successful in promoting private enterprise and in limiting government financial commitment to industry. But what has been the cost of the achievement? Have industries gained? Is the public better off now with less government participation? The privatisation legacy is assessed by reviewing the relative achievements of its initial goals. These goals were:

i. Raise revenue in order to cut the PSBR
ii. Increase competition and efficiency within industries
iii. Create a 'popular capitalism' by increasing the number

of shareholders.

iv. Reduce the government's involvement in industry

i. Cutting the PSBR

During the period 1979-1991, successive Conservative Governments have raised more than £35 billion through the privatisation programme. This revenue greatly improved Britain's PSBR in the short run. The drain on the public purse caused by inefficient State-owned enterprises has lessened considerably. Many industries have been deregulated. The government has not reneged on its responsibility to 'provide' essential services. The government has only stopped 'producing' many of them. Whether retaining 51% of a privatised firm or holding only one single 'special' share, the government has maintained some influence over its activities.

In Britain revenue raised from share sales reduces that year's PSBR. Viewed as 'negative expenditure', the revenue raised is subtracted from gross PSBR resulting in a smaller net PSBR. Under the British national accounting system, sales proceeds of £X billion are recorded as an £X billion reduction in central government expenditure (MacAvoy, Stanbury, Yarrow and Zeckhauser, 1989, p218). When a large flotation such as BT or British Gas raises revenue over a number of years because of the instalment system, the PSBR of each of these years benefits. However, the effect on the

PSBR is not so simple. Mayer and Meadowcroft (1985, p53) have explained the likely effects of BT's sale on the 1985/1986 PSBR. In that year the government received £1.2 billion from the second instalment. It is not correct to surmise that the PSBR fell by that amount. BT was (and is) a highly profitable company. Its gross trading surplus for 1985/1986 was £3 billion. Even if one assumes that much of this surplus would have been re-invested into the company rather than used to reduce the PSBR, the true effect of the second instalment revenue is less certain. The government also earned dividends from its 49.8% holding in the privatised BT and also from taxes on dividends earned by other shareholders. Thus the PSBR does not predictably fall as a result of a large flotation.

Rolls Royce was sold for £1.3 billion but only after the government wrote off losses of £372 million and repaid loans of £283 million. A more striking case was that of the National Frieght Corporation where the revenue raised was re-invested into the company's pension scheme. The public gained nothing except another privatisation bill. The same may be said of the TSB sale.

A particular critique of privatisation revenues is that of the selling price of companies. This chapter has already discussed the failure of central government to determine a fair price for a State-owned enterprise about to be privatised. This apparent miscalculation is, in part, politically motivated. High premiums earned by investors on the first day of trading and huge oversubscriptions for shares are rough indicators of the government's apparent miscalculation of the company's worth.

Examples of high premiums are TSB and Rolls Royce where the share price rose from 100p to 177p and 170p to 288p respectively, on the first day of trading. Premiums were especially large for the sale of shares in companies not previously quoted on the Stock Exchange. Massive oversubscription for shares in Amersham International (25 times), Associated British Ports (1983, 34 times) and BA (32 times) further indicate the government's inability or unwillingness to maximise sales revenue. The loss of revenue seems to have been greater when a company was sold with a fixed price offer for sale rather than with a sale by tender. Of course, the government is more pleased with an oversubscription and/or a positive premium than under-subscription and capital losses for the small investor-cum-voter.

There is another factor that has caused the privatisation contribution to PSBR to be less than it may have been. The costs of the programme have been great. Advertising, underwriting and legal costs have been hugely expensive There have also been the costs of loyalty bonus schemes, redundancy payments, loan repayments and the loss of cross-subsidisation throughout the economy (Steal and Heald, 1985, p82). The government may be critised for allowing costs to inflate so highly although many of them are necessary for a successful privatisation.

Jenkinson and Mayer estimate that the costs of sales ranged from 1.7% of gross proceeds (for BP in 1983) to 11.8% (for ABP in 1983). The average, though, at around 4% is below the average for large private share issues (Jenkinson and Mayer, 1988). The Irish government needs to be quite clear that revenue gains from privatisation will necessitate considerable investment in preparation, promotion and legislation.

Any benefits of privatisation on the PSBR have been short lived. During 1990 and 1991 the PSBR returned to a large deficit. Falling tax revenues, falling privatisation receipts and increased public sector pay caused a £10.5 billion borrowing requirement (CSO, 1991). The 1992 budget forecasts a £28 billion borrowing requirement for the current year. The accumulated revenue gains from privatisation, therefore, will be wiped out by the end of 1992. Furthermore, the government has foregone the future income streams from the profits of the former State-owned enterprises.

A clear lesson for an Irish privatisation programme is Britain's occasional sale of a company in tranches. This worked particularly well for the sale of Cable and Wireless. In that case the prices of shares offered to the public rose from 168p in 1981, the first tranche, to 587p in 1985, the third tranche. Similar successes were recorded with the partial sales of ABP and BAe. On the other hand, the 49% and 100% chunks of BT (in 1984) and British Gas were much too great. The revenue raised, though huge, would have been greater if the giants were sold in smaller tranches.

The lesson is clear. It is best to sell an initial small tranche at a reasonably safe (i.e. low) price and then sell subsequent, large tranches at possibly higher prices, perhaps by tender.

Britain's success in achieving goal no. 1 is mixed. Revenue raised has surpassed expectations but a huge amount of money has been missed. The financial gain has been short lived. Britain has returned to a large PSBR. The fall in the PSBR during the 1980s hides the fact that real government spending rose by 11%. Harrison records that spending on social services and health rose by 33% and education rose by 10% in real terms. Interestingly, government financial support for trade, industry and employment fell by 30 % (Harrison, 1989, p263). In short, the public expenditure/GDP ratio, which Heald (1983, p312) calls "an index of sin", did not significantly improve.

The lessons for Ireland are that costs should be minimised, targeted companies should be sold in a series of tranches using a mixture of offer for sale and sale by tender. Alternatively, the company may be sold directly to another company. This minimises costs but may conflict with the other goals of privatisation.

ii. Efficiency

A definitive and much publicised objective of privatisation was the introduction of liberalisation and competition into the targeted industries. These two objectives, admirable in themselves, would lead to the primary aim, efficiency. Privatisation, by reducing the government's role in decision-making, by introducing the profit motive and by subjecting the companies to the rigors of the market-place, was meant to create the conditions for efficient management and successful profit maximisation as well as greater consumer choice. Has privatisation achieved all or any of these?

Many companies have performed remarkably well since privatisation. Amersham International and C&W both increased profits five-fold in the years 1980-1986. BAe's profit doubled while Rolls Royce's profit trebled after privatisation. The Nation Freight Corporation, bought by managers and employees, increased profits twelve-fold while its share price rose 6200%. Jaguar transformed its record from a £44 million loss in 1980 to a £121 million pre-profit in 1986. Yet, since its purchase by Ford, Jaguar's profits have collapsed. This suggests that privatisation is no guarantee of improved profitability and does not protect a firm against losses. The 1991 losses of BSC, the TSB group are further examples.

From this profit point of view, privatisation has achieved many successes. Privatisation has allowed companies such as BP, BT, British Gas and C&W to invest freely in their own futures. They no longer have to answer to the constraints of the PSBR.

It is difficult to be certain that the improvements in profits were the result of privatisation itself. Many of the companies which achieved good profit growth since privatisation, such as BAe, BT and the Water Companies, were increasing profits for several years prior to privatisation. Before their privatisation, BA and National Freight out-performed many private rivals. The government's preparation of a company may have caused the profit increase and this may have been achieveable without the privatisation.

Profit is not the sole benchmark to measure a company's success or its efficiency. A glaring criticism of privatisation is that many of the larger companies have retained their monopoly power. British Gas remains a monopoly. BT competes only with the tiny Mercury. The National Bus Company remains in a largely unassailable position. BA has inherited monopolistic rights to certain routes. The recently privatised Electricity Supply Industry contains very little effective local competition. In fact, the consumer has been offered little in the way of extra choice in the majority of the privatised industries. The government has foresaken true competition in order to increase revenue from the sale. That is, goal no.2 has conflicted directly with goal no.1. A divided, unsheltered British Gas is more difficult to sell than a closeted monopoly. Nor have the companies been fully liberalised. It may be argued that efficiency can never be achieved as long as regulatory agencies such as OFTEL, OFGAS, OFFER and OFWAT interfere in the pricing system. Yet these same agencies are required as long as industries are dominated by monopolies. Of course, in some cases, continued regulation is necessary to safeguard consumer rights and to protect the environment.

Instead of promoting liberalisation and true competition, privatisation has restricted both. The government has failed to realise that withdrawing its involvement in an industry is not sufficient to ensure that competition thrives. Now that the industries are privatised the government must ensure that effective competition is allowed to take place. Privatisation should not be seen as a final step but as a necessary step along the road of liberalisation, efficiency and real consumer choice. From this point of view, Britain's privatisation programme has been grossly inadequate. If an Irish government views privatisation as a way of promoting a more healthy, open, competitive economy, it must go much further than the British government has gone. An Irish government should examine the benefits of franchising and of contracting-out in all sectors of the economy in which State-owned enterprises operate.

The verdict on Britain's success in achieving goal no. 2 is that it has failed. Although the profit motive has been allowed to dominate and a semblance of competition has been introduced, there has been little improvement in consumer choice and in competitive trading. Any improvement in a company's profitability is not a definite result of privatisation alone.

iii. Popular Capitalism

Politically, the widening of share ownership was high on the list of objectives. The hidden strategy was that by increasing the number of people who own shares you increase the number who are supportive of the traditionally capitalist party, the Conservative Party. Meanwhile, the

Labour Party becomes less of an opponent. Clarke discribes privatisation as a "macro-political method of dissolving socialism" (1987).

The success of this goal, like the others discussed above, is ambiguous. The number of people who bought shares for the first time clearly rose. (The increase, though, was from a very low base. The number of shareholders at any time in the 1980s never reached the figures of the late 1950s.) The BT flotation alone doubled the number of existing shareholders. Many other applicants were refused. The sale of shares in BA, BAe, Rolls Royce, TSB and BP (except 1987) attracted many first time investors. The public liked the idea of 'sharing' in Britain's future.

In the longer term, the number of shareholders has increased less dramatically. Many novice shareholders opted to make a quick profit on the attractive premiums available. Mayer and Meadowcroft (1985) reported that although 65,000 people held shares in Amersham International on its first day of trading (25 Feb, 1982), the number had fallen to 8,600 by June of that same year. The number of investors in BAe fell from 158,000 in Feb 1981 to 27,000 in Dec 1981. By the time of BT's and British Gas' privatisations, the government recognised the problem. These sales offered bonuses for those loyal shareholders who held onto their shares for a long period. These loyalty bonuses included additional free shares and vouchers to offset their telephone or gas bills. In effect, the government bribed shareholders to retain shares so that goal no.3 was seen to be effective. Ambivalently, though, the tax system penalises those who hold onto shares. Large profits earned from share trading are subject to capital gains tax. A set of 1988 surveys by Rogerson show that at that time around 19% of the adult population held shares, mostly in privatised companies. In 1979 only 7% of adults held any shares (Rogerson, 1988). In 1988 just over 50% of British shareholders owned shares in one company only (Grout, 1988).

The employee share ownership schemes were more successful. On average, about 90% of employees bought shares in the company for which they worked (Steal and Heald, 1985). 99% of employees in Amersham International, British Gas and C&W and 98% of BAA took up the offer (Veljanouski, 1989, Table 6, p205 and BAA, Annual Report, 1988). Typically, employees were induced to buy shares by an offer of free shares and matching shares (say, one extra share for every two bought). This level of interest helped to popularise privatisation. It also helped to renew employees' commitment to their company. There are two qualifications to this success. Employee-held shares amounted to a very small percentage of total shares and employees were among the first to sell shares.

Widening share ownership is unlikely to become an important goal in any Irish privatisation programme. Revenue maximisation is likely to dominate. In 1992, a second tranche of Greencore shares were sold through a private placing. The effect of this on the number of shareholders was minimal.

iv. Less Government

A fourth goal of privatisation linked to each of the three discussed already, was that it should result in less government interference. That is, the liberalisation and competitive advantages of being private would allow less government interference in the running of the company and in people's lives. This philosophy believes that people should be free to determine their choice of schools, hospitals and suppliers of public services. Privatisation should allow more choice, and greater choice suggests greater democracy.

In many ways this objective of privatisation has succeeded. Many of the services traditionally produced directly by the government and many of the industries traditionally supported by government are now provided by privately supported companies. The public expect less from the government. The government is no longer obliged to intervene directly in the market-place.

One disadvantage of this type of governing is a possible loss of sovereignty. Aware of the British public's pride in national companies, the government broke rules to ensure that the Rover Group was bought by BAe. However, it could do nothing to stop America's Ford from taking over Jaguar, a most British company. That the government retains a 'special' share in a company is no guarantee that foreign ownership or a hostile take-over may not one day occur. In some cases the 'special' share is held for just a five year period and in most cases the 'special' share is not part of the privatisation legislation but part of the company's Memorandum and Articles of Association. It can, therefore, be removed without legislation (Wiltshire, 1987, p45). The 'special' share also conflicts with the efficiency goal. A truly competitive and liberal industry allows predators to take over weak, inefficient companies. Aylen asserts that the, "mere presence of the threat of an unwelcome bid should spur managers on to watch the interests of their shareholders and restrain their own tastes for growth, capital spending, a quiet life or anything not consistent with maximising the value of the firm" (Aylen, 1988). The 'special' share directly prohibits this.

Nor has privatisation allowed the markets to be truly free from government involvement. Legislation and regulation ensure the government's continued interference in industry. In many cases direct State involvement has been replaced by direct State regulation. The government is involved more and more in controlling or supporting competition. The strict and complex nature of the typical regulatory framework likens it peculiarly to the old public corporation structure which privatisation sought to remove.

The degree of direct government intervention has decreased in Ireland. Although privatisation has not yet developed into a common political policy in Ireland, several deregulatory and liberalising programmes have lessened the government's direct participation in industry. These are explored in Chapter Five.

This brief assessment of Britain's privatisation programme has credited it with considerable success. Britain has nurtured privatisation so that it is now a mature political and economic tool throughout the world. Like any nurturing, mistakes have been made. Some of these were circumstantial but most resulted from a conflict of goals.

TABLE 3.1 BRITISH SHARE FLOTATIONS

NAME	NATIONALISED / CREATED	DAY OF SALE	OFFER PRICE	REVENUE	TIMES O'SUBS	GOV'T HOLDING	PREMIUM +
AMERSHAM	1954	18/02/82	142p	54m	24	'SPECIAL'	32%
ABP	1906	09/02/83	112p	21m	34	48.5%	34%
	(BTOP)	17/04/	270p	52m	1.2	NONE	2%
BA	1939	06/02/87	125p	892m (For BA)	32	NONE	68%
BAA	1965	1987	245p (o)				14%
			282p (t)	1225m	7	'SPECIAL'	(w)
BAe	1977	13/02/81	150p	143m	3	48%	19%
		13/03/85	375p	550m	n/a	'SPECIAL'	(w)
BRITISH GAS	1949	03/12/86	135p	5100m	4	'SPECIAL'	20%
BP	1914	24/06/77	845p	564m	n/a	51%	n/a
	(Anglo-	09/11/79	363p	276m	1.5	46%	2%
	Persian)	23/09/83	435p	543m	1.3	32%	3%
		10/87	320p	7200m	Only 3% sought	'SPECIAL'	
BRITOIL	1974	19/11/82	215p (t)	548m	27%(under)	49%	-14%
	(BNOC)	19/08/85	185p	462m	n/a	'SPECIAL'	-22%
BRITISH STEEL	1967	11/88		1800m	3	'SPECIAL'	n/a
BT	1912	28/11/84	130p	3916m	5	47.7%	80%
	(POST	09/12/89	305P (s)	5350m			5p
	OFFICE)		350P (b)		2.5	26%	15p
CABLE AND WIRELESS	1947	30/10/81	168p	224m	n/a	50%	21%
		02/12/83	275p (t)	262m	Only 7%	23%	-2%
		11/12/85	587p	933m	n/a	'SPECIAL'	n/a
ELECTRICITY SUPPLY INDUSTRY	VARIED	12/90-03/91	VARIED	5200m	10.7	VARIED	50% (Av)
ENTERPRISE OIL	1982	27/06/84	185p	380m	Only 66% sought	'SPECIAL'	n/a
JAGUAR (BL)	1975	09/84	165p	293m	7	'SPECIAL'	8%
ROLLS ROYCE	1971	07/05/87	170p	1360m	9.4	'SPECIAL'	73%
TSB	VARIED	09/86	100p	1300m	7	NONE	77%
WATER INDUSTRY	VARIED	1990-1992	VARIED	3600m	n/a	VARIED	n/a

(<u>Sources</u>: Neuberger (1987), Wiltshire (1987), Veljanouski (1987), Fraser (1988), Ramanadham (1988), Vickers and Yarrow (1988), Veljanouski (1989) and Annual Reports).
(t) = Tender (o) = Offer offer: (s) = Small (b) = Big investor; (w) = end of first week; +All other premiums are end of first day

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CHAPTER FOUR

PRIVATISATION AROUND THE WORLD

I INTRODUCTION

This chapter continues the survey of world experimentation with privatisation which began in Chapter Three. In that chapter the British privatisation programme was explored in detail. The politics, the philosophy and the process of privatisation were also examined. This chapter concentrates on an overview of privatisation in the various regions of the world. The chapter highlights the successes and failures of global privatisation experiments.

The survey begins with the developing programmes of Europe and North America. Then more general attention is paid to the rest of the world. The chapter highlights the reasons for and the approaches to privatisation adopted in each country. In this way some conclusions may be drawn enabling this thesis to examine a privatisation programme for Ireland.

There are great differences in the approaches towards privatisation in each of the countries explored below. Globally, the necessity for, and fate of, privatisation have been influenced by two crucial events.

The energy crisis of 1979 initiated a world recession. Faced with spiralling inflation, high interest rates and accelerating national debts, countries were forced to re-examine their governments' role in the economy. Some, like France, initially chose to increase government intervention in, and protection of, the economy. Most decided to employ contractionary fiscal rectitude. As part of this, some countries adopted privatisation. It was seen as a direct way of decreasing a country's PSBR and national debt.

The interest in privatisation that developed in the 1980s suffered a major setback following a second global economic hiccup. The worldwide stock market crash of October 1987 may not have had the devastating effects as its grand predecessor of 1929 but did strike a direct blow at privatisation programmes. Many countries were, by then, only beginning to pursue privatisation. The collapse of share prices discouraged many governments from selling State assets, especially to small shareholders via the stock exchange. The failure of Britain's flotation of BP at that time served as a sobering example of what can go wrong.

Privatisation has failed to build up the momentum it promised soon after Britain had led the way. Now, in 1992, with a deepening global recession, many governments are again reviewing their role in their economies. The same dilemma remains. Governments, or at least politicians, see a role for the State to protect, if not promote economic growth and well being. On the other hand, high interest rates, the high cost of debt servicing, huge transfer payments, fears of another energy crisis and a world recession are forcing governments to reduce spending and borrowing. Once again the privatisation option is being considered. Meanwhile, European Community opposition to anti-competitive legislation is toughening as the Internal Market approaches. Sir Leon Brittan, the EC Competition Commissioner, has forced Britain's BAe and France's Renault to repay grants and debt write-offs to their governments. Further withdrawal of State intervention is likely.

II EUROPE

FRANCE

For much of the 1980s France was governed by socialists. In the early years of the decade the French government pursued a programme of nationalisation. Like most countries, France was suffering a recession. Like Ireland then, and Britain today, she had to learn to cope with the new disciplines of ERM membership. Intent on promoting innovation, investment and employment, the French government favoured direct intervention in the economy. Industrial firms and commercial banks were nationalised so that investment and growth could be assured. However, before the socialists lost power, they switched the emphasis towards competition and autonomy. The government's role was reviewed and reduced. It was not until the victory of the right-of-centre Chirac government (which lead to 'co-habitation' with the socialist Mitterand) that the privatisation option was pursued.

Soon after gaining power the Chirac government produced a privatisation law that is unique. It listed 65 companies which, according to the law, had to be privatised within five years. The law stated that any individual shareholder cannot hold more than 5% of the company, foreign ownership could not exceed 20% and the government should retain at least a 'special' share, British-style (but this must not be held for more than five years), (Fraser, 1988, p108; Letwin, 1988a, Ch 1). Provisions were also made for favouring the small investor and the employees. Unlike the *ad hoc,* brickwork approach of the British privatisation programme, the French began with clear legislation that dictated the course of all subsequent privatisations. This created immediate confidence in the programme. Its stability was strengthened by that part of the legislation known as the '*noyau dur*'. This 'hard core' principle dictated that a sizeable part of each privatisation be offered to a group of blue-chip French institutional investors, including State bodies. These were guaranteed a proportion of the available shares but at a higher price. Most of the public offers were in the form of tender offers (Jenkinson and Mayer, 1988).

This solid piece of legislation allowed the privatisation programme to begin confidently. Within one year almost half of the proposed sales were already carried out. All sales were under the control of the Treasury (unlike in the UK where the relevant ministry took control) and all share prices were determined independently of the government. The majority of investors were new, small shareholders, most of whom opted to hold on to their new assets (Humphreys, 1987).

The programme included the sale of State-owned enterprises throughout the economy. In manufacturing, *Compaignie de Saint Gobain*, glass makers, was one of the first to be sold. The sale raised a respectable FFr8 billion (IR£0.9 billion) having been fourteen times oversubscribed (Fraser, 1988, p119). The government also sold companies involved in electricity, telecommunications and nuclear energy. Thirteen insurance companies were sold. *Societe Generale,* for example, raised FFr21 billion (Jenkinson and Mayer, 1988). In the banking sector the government not only privatised the banks that had been nationalised by the previous administration but also sold three large banks nationalised by De Gaulle. These sales allowed the financial sector to consolidate in preparation for the Single Market of the EC. Other sales included part of government holdings in car makers, Renault and in the television station TF-1. Unlike its British counterpart, the French government always sold 100% of the privatised firm (bar a 'special' share). It did not adopt the successful British ploy of allowing investors to buy their shares in instalments.

France's privatisation programme began enthusiastically but failed to gain the popularity achieved in Britain. The government lost its mandate when, in 1988, a socialist government under Rocard was elected to power. Since then the privatisation programme has been set aside in favour of selective government intervention. President Mitterand banned any further privatisation or nationalisation. But budget constraints have forced the government to overlook this ban. In 1991 it permitted SOEs to raise new capital from the private commercial and financial sectors, although no new flotation is allowed and the State's control and ownership of a company may not be diluted. The largely State-owned car manufacturer, Renault, has already announced a joint venture with Volvo. The Swedish company will inject FFR 5.1 billion into the indebted Renault (Financial Times, 17 June, 1991).

If an Irish government favours privatisation it may learn from France's use of concrete, unambiguous legislation that covers the privatisation process. Such an approach seems preferable to the piecemeal legislation evident in Britain.

GERMANY

The success of the German economy may be due partly to the small level of State ownership of enterprise. By maintaining a hands-off approach, the German federal government has allowed the economy to become the highest exporter *per capita* in the world and to earn the world's second highest foreign trade surplus (after Japan), (Smith, Patterson and Markl, 1989, p150). Germany remains the strongest member of the EC and the dominant player in the European Monetary System.

Germany's privatisation programme has been erratic. Much divestiture occurred in the early 1960s. Part of the government's share in Volkswagen and in the energy and chemicals company VEBA were sold (<u>National Westminster Quarterly</u>, 1991). Recent privatisations in Germany have been few and irregular. In 1984 part of the government's remaining stake in VEBA was sold for Dm800 million (IR£360 million). The next sale was not until 1986 when the government's 40% holding in another energy and chemicals company VIAG was sold. Also in that year the industrial and transport group IVG was partially privatised. Since then the remaining State holding in VEBA, the entire State holdings in *Salzgitter* (steel engineering) and in the *Deutsche Verkehrs-Kredit-Bank* have been sold. The DM2.5 billion raised by the *Salzgitter* sale were placed into a fund to finance protection of the environment (<u>The Economist</u>, 24 Nov, 1990, p113). This brought new support for privatisation.

Most sales have been awkwardly carried out. Many were achieved only after years of postponement and political debate. These included government stakes in Volkswagen and Lufthansa (The Economist, 23 Oct, 1989). In total the privatisation programme of 1984-1988 raised about Dm7 billion. Plans remain for sales of *Bundespost* and of industrial companies. A deregulation commission set up in 1987 resulted in widespread deregulation of air transport, trucking, telecommunications, insurance services and of the stock exchange (Donges, 1990, p7).

The high costs of Germany's reunification may force the federal government to accelerate its privatisation programme. The German Trust Company, *Truehandenstalt,* is responsible for the sale or liquidation of many thousands of businesses in the former GDR. Business and Finance report that *Truehandenstalt* is selling as many as 520 companies each month in a "massive game of Monopoly" (Business and Finance, 5 Dec, 1991, p14). Although most buyers are Germans, the French, Swiss and British have also acquired many enterprises. The largest sale has been the DM2.2 billion privatisation of an East German hotel group to Berlin developers (Business and Finance, 5 Dec, 1991, p16). Those State-owned enterprises that remain may be the most difficult to sell (OECD, 1991, p75). Although the sale of State companies in the East will fall far short of the cost of reunification, the sale of financial assets held by public authorities in the West could raise DM370 billion

(The Economist, 24 Nov, 1990).

ITALY

Italy has had a long history of State controlled industry. The State has been directly involved in the manufacturing and financial industries to a much greater extent than its EC partners. The government's involvement in a wide range of companies has been governed by three holding companies: *Instituto per la Ricstruzione Industralie* (IRI), dating from 1933, *Ente Nazionale Idrocarburi* (ENI), 1953, and *Ente Partecipazione e Finanziamento Indusrtria Manifatturiera* (EFIM), 1962 (Fraser, 1988, p131). These concentrate in the areas of general industry, energy and engineering. They are charged with the management of the government's interests in these sectors. Part of that management includes occasional sales of State shareholdings.

In the period 1983-1987 the three State holding companies sold L7,000 billion (Ir£3.6 billion) worth of State assets (Fraser, 1988, p131). These included many types of companies. The government introduced much deregulatory legislation. The telecommunications and the financial industries were liberalised. In 1985 the government introduced a private television network, free to broadcast nationwide (Leonardo and Nanetta, 1986, pvi). Privatisation is likely to follow the deregulation and liberalisation that are occurring in the banking sector. Liberalisation is deemed neccesary to allow the large number of small banks to consolidate and strengthen before the end of 1992 (Sington, 1990).

One sale that attracted criticism from the European Commission was the sale of Alfa Romeo to the Fiat group for L400,000 million. The Commission accused the government of breaking EC competition law because it had refused an offer by America's Ford to buy only 20% of Alfa Romeo for L360,000 million.

The Italian privatisations were largely unspectacular. The companies were most often sold whole or piece-meal directly to other companies. The privatisation programme was not seen as a way of widening share ownership. When a share flotation was the chosen method of sale, large blocks of shares were reserved for strong institutional investors, similar to the French programme. There may be a political reluctance to privatise as public enterprises are important contributors to political party funds (Euromoney, July, 1990, pp72-77). Nevertheless, privatisation proceeds are expected to amount to L15 trillion for 1992 (OECD, 1991, p90).

SPAIN

The Franco era produced a very high number of State-owned enterprises. In 1941 Franco founded the State holding company, *Instituto Nacional de Industria* (INI), closely copying the Italian IRI. The INI bought many failing private enterprises and helped to create a lame Spanish economy. The legacy of Franco's dictatorship was a country suffering from high protectionism, technological retardation and a stagnant export sector (Lancaster and Prevost, 1985, p35). Spain did enjoy some industrialisation and growth during the 1960s. But the oil crises of the early 1970s stunted that growth and set the economy on a decline.

After Franco's death in 1975, nationalisation gathered pace in a desperate effort to instill life into the economy. This period of isolation, protectionism, rising debts and economic gloom lasted a decade. Soon after its entry into the EEC in 1986, Spain began to liberalise and deregulate. Symbolically, the Spanish stock exchange was deregulated and investments were allowed to circulate freely. The INI began to sell some of its holdings in public companies. Typically, the sales were in the form of a private placing or a direct sale. SKF (*Espanola*) was sold to its parent company in Sweden. The loss making SEAT car company, formed in 1950, was sold to Germany's Volkswagen who later transformed its fortunes.

As confidence grew experiments were made with share flotations. In 1986, a year when the share index of the Spanish stock exchange doubled, INI sold 38% of the energy company *Gas Y Electicidad* to 58,000 private shareholders

(Fraser, 1988, p138). 20% of *Repsol SA*, Spain's State holding company for the petroleum sector, was sold in 1990 (Marketing and Research Today, Feb, 1991). Further deregulation and privatisation took place in television, telecommunications, energy and rail travel insurance.

Spain's privatisation programme has been relatively large. Spain has successfully embraced EC membership, free competition and market liberalisation and is poised to contribute significantly to the emerging Single European Market.

OTHER EUROPEAN COUNTRIES

Most of Europe has experimented with privatisation in the last ten years. For most, progress has been slow. The worldwide stock market crash of October 1987 slowed progress further. Most countries have privatised only in those areas where success was almost guaranteed. For most, privatisation was only one element in a programme of deregulation and liberalisation.

In the **Netherlands** the economic crisis of the mid-1980s and the State's budget deficits attracted the privatisation option. The State-owned relatively few enterprises. Since 1987 there have been a few small sales. The most significant flotations have been stakes in *Postbank*, the State airline KLM and the chemicals firm DSM. In 1989 the Dutch Consumer

Association complained that the State monopoly of telephone equipment sales was wrong. It took the government to court and won. Subsequently, telephone equipment sales were deregulated (Letwin, 1988a, Ch4). That case is representative of the direction of policy in the Netherlands.

In **Belgium**, meanwhile, privatisation had already begun. It was the necessity to rectify soaring budget deficits that prompted privatisation. The Belgium government was heavily and directly involved in the economy. 30% of the government's stake in SNI, a State investment company, was sold for BFr32 billion (Ir£600 million). Half of that sum was again raised through the sale of 25% of *Sabena*, the national air carrier. Over Ir£1 billion was raised by selling the State's holding of the postal and telephone authority (Fraser, 1988, p127).

Like Spain, **Portugal** has amassed a large amount of State-owned enterprises. An extensive nationalisation programme began in 1975. Article 83 of the country's constitution refers to the irreversibility of nationalisation. In 1987 the losses of State-owned companies totalled IR£3.5 billion (Fraser, 1988, p135). The government of that year dedicated itself to lowering direct State involvement in the economy. The government was involved, directly or indirectly, in almost one thousand firms. Prime Minister Silva outlined a denationalisation package. He believed that although some SOEs providing essential services would always remain public, there was much room for State withdrawal from many sectors of the economy. The constitutional restriction narrowed the government's options. But 1988 legislation permitted the sale of up to 49% of State holdings in any State-owned enterprise. Without delay, five national newspapers were sold. Privatisation was also unleashed in the broadcasting and telecommunications sectors.

Two countries not aligned with either the east or west political divisions of Europe, but with a strong tradition of State subvention, have been very active in privatisation. These countries are Austria and Turkey. By the mid-1980s both countries were crippled with inertia and financial doom due, largely, to an unwieldly State sponsored sector. Their difficulties were so severe that they attracted the attention of the IMF.

When one of **Austria**'s State holding companies OIAG lost Sch12,500 million (IR£700 million) in 1985, the coalition government decided to act (Fraser, 1988, p135). During 1987 and 1988 Austria began a privatisation programme designed to reduce budget deficits and to help finance the restructuring of the ecomomy. 15% of the oil and gas group OMV was sold. Small percentages of the State's holdings in enterprises involved in banking, electricity generation and in the airline industry were also sold (Jones, 1988).

Around this time **Turkey** began to sell some of its weak State-owned enterprises. President Ozal had been installed as Prime Minister following a military coup. He viewed privatisation as a necessary tactic in revitalising the economy and in creating healthy competition and economic efficiency. The success of his privatisation and liberalisation policy helped towards his re-election in 1983. Shares in the Bosphorous bridge (linking Asia and Europe) were sold as well as shares in the Keban Dam. Both sales were popular and successful. The 22 companies listed for sale in 1987 were chosen because they were attractive to buyers, not because they were sensible sales (Leeds, 1988). They included SOEs involved in cement manufacturing and in telecommunications. *Teletos*, a telephone equipment producer, and *Citosan*, a cement manufacturer, have already been sold. Following a World Bank plan to restructure the economy, the government has established a State department responsible for over-seeing the privatisation programme (Leeds, 1988).

The privatisation schemes of Turkey and Austria were adversely affected by the 1987 shares crash and by their own under-developed capital markets. Privatisation, therefore, has proceeded more slowly than was envisaged earlier in the 1980s.

Political developments within **Eastern Europe** have transformed the economic role of each nation's government. Even before the popular risings of 1989, the governments of the then Eastern Bloc satellites were decentralising and divesting. Of course, there was no British-style flotations. Instead, the influence of the State was lessened by allowing new investments by self-managed indigeneous enterprises and, occasionally, by joint ventures with foreign companies. Inspired much more by Gorbachev's *Glasnost* and *Perestroika* philosophies than Mrs Thatcher's Rightism, the governments attempted to restructure State industries by allowing greater openness and greater autonomy. The sincerity of the attempt varied from nation to nation. But in every case the attempt was not enough. The people rose and the State system collapsed.

As democracy spreads throughout Eastern European, liberalisation of markets is presenting new choice and independence. The governments, in an attempt to quench the populist thirst for democracy, are rapidly withdrawing their support for and intervention in industry. Rapid divestiture is taking place. However, unlike the cases of privatisation explored hitherto in Part Two, when the governments of the newly democratised European countries withdraw their direct involvement in an industry their place is not quickly filled by enthusiastic, wealthy entrepreneurs. When interested entrepreneurs do come forward they are most likely to be foreign capitalists.

Poland and Hungary are now allowing foreign capitalists to buy up to 100% shares in local firms (The Economist, 11 Feb, 1989). **Hungary** introduced "spontaneous privatisation" (The Economist,17 Nov, 1990). which allows managers of SOEs to organise the sale of their company to the private sector. Foreign investors are encouraged by preferential tax rates.

In 1990 **Poland** passed a general privatisation law. The State owns about 7,000 companies (The Economist, 17 Nov, 1990). The government planned to sell twenty to thirty SOEs within a year. All privatisations must have the backing of workers, management and the government (who must conduct a feasibility study on the sale beforehand). The Ministry of Property Transformation oversees the process (Whisenhand, 1990). Small privatisations are allowed in **Czechoslovakia.** Poland and Czechoslovakia plan to give vouchers to every citizen so that they can 'buy' a number of shares in privatised companies. More vouchers can be bought at a discount. (The Economist, 17 Nov, 1990).

The governments of Eastern Europe ought to divest in a more orderly and less rapid fashion than they would wish. The timing of the withdrawal of State aid has to be right to avoid chaos in the markets and a collapse of economic order.

That chaos and that collapse are, perhaps, imminent within the **Commonwealth of Independent States** (CIS).There the speed of the withdrawal of State support is leaving a void too great to be filled by even the most zealous capitalists. The process of introducing a market economy, always envisaged as a difficult one, has been chronically painful. The leaders of the CIS are divided about the steps that should be taken and the speed of their execution. In many cases the CIS and its former socialist allies are set to carry out a privatisation programme greater than any seen before. A successful privatisation in the CIS was the employee buy-out of the Moven Ventilator factory in Moscow in 1990. In one year output rose by 25% and profits reached thirteen million Roubles (The Economist, May 18, 1990, p82).

III NORTH AMERICA

THE UNITED STATES OF AMERICA

The federal government of the USA does not have a long tradition of direct involvement in industry. Instead, the spirits of democracy, freedom and enterprise are expected to provide an adequate market system. Direct federal government involvement has mainly been restricted to the areas of defence, transport, education, social welfare and law and order.

The privatisation that has taken place has mainly been in the forms of contracting-out and deregulation. In recent decades deregulation has liberalised many industries. In 1968 private firms were allowed to compete with AT&T in the sale of terminal equipment (Okun, 1986). The television, radio, oil, gas and bus and rail travel industries and the financial sector have all been widely liberalised. Research by Bailey (1986) shows that the deregulation of the haulage, railway, stock brokerage and air transport industries resulted in a fall in prices and an increase in choice for the consumer. Efficiency improved but the entry of many new companies resulted in considerable turmoil. The USA pioneered the deregulation of the airline industry during the 1970s. During the period 1980 to 1986, 20 new airline companies were set up as a result of further deregulation. Caves (1987) monitored the performance of US airlines since deregulation. He estimated that by 1983 deregulation had lowered US airline costs by 10% resulting in "savings, in 1983 alone, of over $4 billion". This widespread deregulation may have contributed to the collapse of the PanAm company in 1991.

Divestiture of federal assets became a political option in the 1980s because of the country's massive budget deficits. In 1985 the Gramm-Rudmann Amendment forced the government to achieve a balanced budget by 1991. (In 1990 the deadline date was revised to 1995.) The government had to cut subsidies and to raise revenue through divestiture. In 1987 Conrail was sold for a record $1.65 billion (IR£1.05 billion) via a share flotation on the New York stock exchange (Letwin, 1988a, p17). The AT&T telecommunications company has also been sold.

With less funding from federal government and with the option of raising taxes politically difficult, State governments have been forced to improve the cost effectiveness of their public services. Although some assets, mainly land and housing, have been sold, the State governments have preferred to contract services out to private enterprises. By 1986, 35% of local government had contracted private firms to collect domestic refuse, 42% used them to operate and maintain bus systems and 80% contracted out the task of vehicle towing and parking

(Butler, 1986). Some States have contracted out the running of hospitals, schools and prisons. Broder (1991) reported cases in Chicago where many services such as tree trimming, janitorial services and the towing away of abandoned cars have been contracted out to private firms. This allows the police and other public servants to concentrate more on essential services.

Through contracting-out the governments have withdrawn from direct involvement in industry and in people's lives. The contracting-out process ensures that essential services are provided and at a lower cost. Poole (1988) reports on studies of the efficacy of privatisation in Southern California. Data reveal that municipal provision of street sweeping was 43% more costly than competitive private enterprise, traffic signal maintenance was 56% more costly, and asphalt paving and repair was almost twice as costly. Cox (1987) reported that the costs of private, competitively contracted transport services in San Diego, California were half the costs of the previous public transport monopoly.

CANADA

Canada, like Ireland, does not have a long tradition of nationalisation. Instead, most of the Canadian Crown Corporations were set up during this century to aid economic growth and development. Government intervention in the economy has been more through regulatory legislation than direct ownership of enterprises. For this reason the scope for privatisation has been limited. Yet progress has been made.

Like so many others, the Canadian government was inspired by the success of British Telecom's flotation in 1984. Canada began to examine each Crown Corporation to see if it would benefit from private ownership. To begin, the Prime Minister appointed a Ministerial Task Force on Privatisation in 1985. The following year a Minister of State for Privatisation was appointed and an Office of Privatisation and Regulatory Affairs was founded. This all led to a privatisation strategy that was thorough although cumbersome.

There have been several sales, mostly direct to private enterprises. As in most countries the high profile targets of airlines and telecommunications were the first to be focussed upon. In 1986 the DeHavilland Aircraft of Canada Co was sold to America's Boeing Co. for Can$180 million (IR£165 million) Canadair Ltd was sold to the Bombardier Co. for Can$300 million. Air Canada has raised fresh capital from the market, effectively diluting the government's stake. Teleglobe Canada was sold for Can$600 million to Memotec (Trupper and Doern, 1988, p7). Other direct sales included the Northern Transportation Co Ltd and Canadian Arsenals (Fraser, 1988, Ch11).

The government has been more hesitant to sell a Crown Corporation through a stock market flotation. It did so with the Canadian Development Corporation and Fishery Products (Kierans, 1987). Like France, the government usually divested its complete stake in the company.

The State governments have been a little more adventurous with privatisation than the federal government. The extreme case of privatisation (discussed before in this thesis) was the sale of virtually all the SOEs of British Columbia. There the State grouped most of its assets together to form the British Columbia Resources Investment Corporation. Every British Columbian citizen was given five shares in the new corporation. 170,000 citizens bought the remaining shares raising Can$487.5 million for the State (Walker G, 1988). Since the sale the State has been criticised for investing poorly in weak companies. A second failure of the experiment has been the administration of over two million shareholders. That task has been too difficult and too costly (Hardin, 1982, p89).

The province of Alberta sold the Alberta Energy Company and Pacific Western Airlines. The State of Saskatchewan successfully sold Sask Oil. Other States have sold few assets, opting instead to contract out public services.

The Canadian privatisation programme has been well structured, overseen by an Office of State and a Minister for State. As a result of this solid structure the process has been slow and cautious.

IV LATIN AMERICA

The countries of Latin America are not an homogeneous group. Their collective name hides the variation of wealth and economic development. Within each country there are great inequalities of wealth and power. It is difficult to speak of the continent as one whole. Some progress is made, however, by dividing the countries into those that have developed successfully in recent decades and those that have not. Emmeriz (1987, Tables III.3 and III.5) illustrates how the fortunes of many Latin American countries have diverged over recent decades. Guyana and Nicuagua were no better off in 1985 than they were in 1960. El Salvadore and Argentina enjoyed the same wealth *per capita* in 1985 as they had in 1964 and 1967, respectively. On the other hand, Barbados, Brazil and Panama have more than doubled their GNP *per capita* over the 25 year period since 1960.

The degree of State intervention varies too. In most cases the State is heavily and directly involved in industry. The combined deficits of the State-owned enterprises in the seven largest Latin American countries rose from 1% of GNP in the mid-1970s to 4% in 1982 (World Development Report, 1987). It is difficult to know if this is a result or a cause of each country's poor economic performance.

Governments were often forced to take over crippled companies and those involved in exploiting the nation's resources. The advice of the IMF and the World Bank in the 1950s and the 1960s was for the government to pursue a hands-on, interventionist approach to development. Now these same agencies are insisting that governments withdraw that same support and involvement. Privatisation is seen now as an important step forward (or is it backward?) to improved growth.

The cumulative foreign debt of Latin America has increased greatly since the mid-1980s. The sub-continent had to endure the crippling interest rates that were part of the so-called Reagonomics of the early 1980s. Latin America had to pay an extra $1.8 billion (IR£1.2 billion) for every 1% increase in the US prime interest rate. (That rate reached an all time high of 21.5% in May 1980 [Branford and Kaucinski, 1988, p95]). Mexico's interest bill tripled in the three years 1979-1982. In most countries further borrowing was necessary to service the existing debt. By 1987 cumulative Latin American foreign debt reached $409 billion (in 1980 it was $222.5 billion) (Branfore and Kaucinski, 1988, Figure 1.1, p2). The need to reschedule Latin American debt became chronic. Few countries could service their debt without increasing their borrowing. All needed more time, more flexibility. The crisis climaxed in 1985 when Peru rejected IMF demands for interest repayments and increased fiscal rectitude. Major banks feared that other debtors may do the same (Roddick, 1988, p159).

A new initiative emerged known as the 'Baker Plan'. This American initiative sought to combine economic growth with the continued servicing of debt. The role of the IMF became that of lender of short term loans. The World Bank oversaw each nation's economic policy (The Economic Intelligence Unit, 1987, p9). The Baker Plan required governments of debtor nations to remove obstacles to growth and competition. This required the elimination of controls, the debureaucratisation of procedures and, where possible, the divestiture of State-owned enterprises (Pastor 1987). In return the plan offered $32 billion in new loans over three years to the 15 biggest debtor nations. Of this sum, $20 billion would come from commercial banks and $12 billion from lending agencies such as the World Bank (Roddick, 1988, pp54-57). The Plan was given an early test with the debt rescheduling programme for Mexico in 1986. The Plan overcame all but one crucial obstacle. Creditor banks were reluctant to adjust interest payments and unwilling to provide bridging loans. The Economic Intelligence Unit (1987) concluded that the implicit aim of the Baker Plan, "that a period of adjustment on the part of debtor countries would lead to a restoration of their creditworthiness in the financial markets and the resumption of spontaneous lending has not yet anywhere been realised" (p10).

The Baker plan has succeeded in highlighting the need to allow debtor nations to pursue economic growth together with stabilisation policies. IMF policy has moved a little from strict demand management / debt servicing towards some element of growth policy. The Baker Plan has also highlighted the near hopelessness of the debt crisis. One successful, if small, solution has been debt-for-equity swaps whereby investors can acquire State assets. This is a form of privatisation. Other possible solutions to the debt problem include debt-environment protection swaps, debt-child survival swaps, debt-development swaps and interest rate capping (Roddick, 1988). In many cases the SOEs have become unattractive and nonviable because of the degree of State protection in the past.

The approach to privatisation varies among the countries of Latin America. Many are pursuing privatisation by stealth. Venezuela is an example of a country that is privatising by allowing private industry to involve itself in new infrastructural projects (DeEscabor, 1988). Private entrepreneurs have more wealth and initiative to develop new projects than the debt ridden, politically unstable governments. The governments in Latin America are welcoming the private investment despite fears that it is allowing multinational companies to gain a tighter grip on their economies.

Privatisation is also taking the form of direct sales. **Chile** is one of the first countries in the world to develop a divestiture programme. Between 1974 and 1980 Chile sold 130 SOEs, valued over $940 million (Shirley, 1983). More than 250 firms, nationalised during the years 1971 to 1973, were also returned to the private sector (World Bank, 1983). Marshall and Montt (1988) have divided Chile's programme of privatisation and deregulation into four phases since 1973. First was the transfer of expropriated enterprises (1974-1975). Then the government sold a group of SOEs (1975-1979). The government began the 1980s with the sale of weak, bankrupt State corporations. More recently, large public corporations have been sold. Marshall and Montt believe that while the degree of privatisation has been phenomenal, it has not been accompanied by sufficient deregulatory legislation. Open competition has not emerged.

Argentina, a country with a massive public sector that is largely loss-making ($5 billion were lost in 1989 [Staubus, 1990]), began its privatisation programme in 1986 with a restructuring of the economy. Any sale of State assets must have the approval of the country's creditor banks. In 1987 *Austral Lineas Aereas* and *Aerolineas Argentines*, airline companies, were sold. So too, was *Entel*, a telephone company (Fraser, 1988, Ch 12; Staubus, 1989). The re-election of the Menem government in 1990 accelerated the privatisation programme. 40 State-owned firms were targeted for sale.

Bolivia has concentrated on the sale of State-owned tin mines. The government's policies of fiscal rectitude, deregulation and divestiture over the past few years have helped to bring inflation down to under 20% from a high of 24,000% in 1984/1985 (World Bank, 1988).

Brazil has a list of 250 public enterprises which are to be partially sold (Cook and Kirkpatrick, 1988, p27). A Privatisation Council conducts each privatisation. A Ministry of Debureaucratization has been formed to cut down on regulation and licencing (World Bank, 1983). Already Brazil's second largest company, *Nova America*, has been sold (Kapstein, 1988). Since the election of a new federal government in 1990 the privatisation programme has gathered pace. The airline VASP was sold in 1991.

Mexico's privatisation plan involves almost halving the number of SOEs to 500 (Fraser, 1988, Ch12). By 1990, 230 companies were privatised raising $3 billion (The Economist, Oct 6, 1990, p119). Two major sales, a telephone company and a copper mining company, occurred in 1990 (Shoreham, 1990). Private partners are being sought for the country's 18 State banks (<u>Euromoney</u>, Sept, 1990, p163). The airline companies *Aeromexico* and *Mexicana* were partially privatised in 1988 and 1991, respectively.

Jamaica has plans to sell television stations, airlines and petrol companies. Jamaica has already sold 51% of the State's equity in the National Commercial Bank, the second largest in the country. The aim of the public flotation was to "demonstrate the merits of privatisation, rather than to maximise government revenues" (World Bank, 1988).

Other countries have been more hesitant in adopting the privatisation option. Privatisation has emerged as one tool in overcoming what may be called the 'Latin American Disease'. Its symptoms include hyperinflation, spiralling debt, underdeveloped capital markets and social and economic inequalities.

Columbia, meanwhile, has spent much of the 1980s going the other way, embracing nationalisation.

Latin America may be the natural environment for privatisation. If the 'Latin American Disease' is the problem, privatisation may be the cure. By withdrawing State subvention and by allowing private enterprises to involve themselves in all areas of commerce, a government can instill some life into a flagging economy.

Privatisation in Latin America is beset by the same problem as privatisation in Eastern Europe. When a government withdraws from an industry, there are few indigenous, profit making enterprises around to fill the gap. A void remains. The under-privileged population are ill prepared to withstand further deprivation in the cause of economic progress. Pressure returns on the government to directly involve itself again in the production of goods and services.

V AFRICA

The African less developed countries (LDCs) are struggling to survive within the constraints of the world's economic order. Few are managing to 'develop' in any real way. Most are burdened by huge external debts, high unemployment, internal political and social strife, unaccomadating climates and a global economic system that works against their primary industries. Their desire to break this poverty cycle is forcing them to look towards radical solutions. For some the priority is to survive another failed harvest. For others civil wars must be settled. Some have used Marxist philosophies to entrench the State's involvement in industry. An increasing number of countries are looking towards privatisation as a way of escape.

The World Bank (IBRD) and the IMF are promoting privatisation in all LDCs. In its World Development Report of 1983, the IBRD said it is time that the "role of the State" be re-examined and that the State ought to "prune what has become unmanageable" (World Bank, 1983). The IBRD and the IMF are attaching privatisation clauses to new issues of their loans (Babai, 1988, Table 1). In return for more development aid, governments of LDCs are being asked to begin steps of withdrawal from industry. The UN Programme for Economic Recovery and Development (1986) called for the role of the State to switch from direct intervention in industry to incentor and facilitator. Those countries most burdened by debt repayments (Ivory Coast, Sudan, Morroco, Zambia [Economic Commission for Africa, 1988, p17]) are most likely to privatise their State-owned enterprises.

The withdrawal from industry is not easy. The history of colonial dominance has created a popular dependence on the State. The people look as they have always done towards the State for guidance, control and direction as well as for jobs and goods. In Egypt one third of workers are employees of the State (Commander and Killick, 1988). The colonial past has also left a legacy of nepotism, corruption and mismanagement. The result is a wholly inefficient public sector in countries among the most etatist in the developing world (Callaghy and Wilson, 1988).

Privatisation in the LDCs of Africa is constrained by a number of factors. The SOEs to be privatised are mostly in poor condition. There is very little foreign interest in acquiring even the best SOEs. The domestic capital market is not sufficiently developed to provide potential buyers. It is the under-development of these countries that hinders them from taking the steps towards development.

Privatisation is not an easy option in countries whose poorly educated populace, unionised workers and undeveloped capital markets restrict any moves forward. The world economic outlook for the 1990s holds little hope for the African LDCs. Increased oil prices, high interest rates, world recession and climatic uncertainties all make the future for the LDCs more bleak.

Some African LDCs have privatisation plans. **Togo** and the **Ivory Coast**, crippled by massive debt servicing bills, are pursuing privatisation. They are selling whatever anyone is willing to buy. Selling, not revenue nor wider competition, is the main objective (Callaghy and Wilson, 1988). **Mali**, where the public sector employed one third of the work force in 1987, began a restructuring programme whereby public enterprises are to be privatised, to be closed or to have some of their capital sold (Economic Commission for Africa, 1988).

Nigeria and **Zambia** have plans to privatise but little has been done to date. Economical, political, cultural and religious difficulties are not easily overcome. In Zaire there have been two real privatisations. Air Zaire and the ship builders CMZ have been sold.

Two African countries with no plans for privatisation are Tazmania and Kenya. The reason in **Tazmania** is straight forward. There, the socialist government has embraced intervention and has nationalised almost 400 companies in the 20 years up to 1987. **Kenya**, on the other hand, would seem a natural environment for privatisation. The State is firmly capitalist. It has introduced corporate reform and has set up a 'Task Force on Divestiture' (Callaghy and Wilson, 1988). But privatisation is unlikely to follow. As well as the usual technical barriers, the government are unlikely to overcome the political lobby of the privileged Kikuyu class. This ethnic group would not tolerate privatisation since it would lead to the loss of State assets to minority Asian entrepreneurs.

As other African LDCs approach privatisation only to find unsurmountable obstacles, they are being left with the most direct and most simple form of privatisation, closure.

VI ASIA

Most Asian countries envy the so-called 'gang of four'. The four newly industrialised countries of Hong Kong, Singapore, South Korea and Taiwan have shown what appropriate economic strategies can achieve in less developed regions of the world. Their export-led growth fully exploited the region's comparative advantage in labour costs. Their government have intervened sufficiently to allow entrepreneurship and competition to develop.

Most Asian countries are not like these. Most Asian LDCs, like those in Afica and Latin America are plagued by huge inflation, massive national debts, crippling unemployment and lame infrastructures. Most, too, have a burdensome public sector. Privatisation is an attractive policy but one, as in Africa, not easily achieved.

Malaysia seems better able than most to catch up with the 'gang of four'. In 1987 a major privatisation programme began in Malaysia. The Public Telecommunications system and the Malaysian Airline System were partially sold. Contracting-out has been introduced in most public services (Craig, 1988).

The **Phillipines**, too, have realistic aspirations of joining the privileged four. First, the social, political and economic crises that followed the Marcos regime must be resolved. Decades of corruption have blurred the division between public and private enterprise. Many private enterprises were really owned by, and puppets of, publicly owned corporations. Marcos, anxious to consolidate his power, continuously nationalised private enterprises. Haggard (1988) reported that, "on average, from 1975 to 1984, total annual transfers to State-owned enterprises were 1.2 times the budget". Realising the problem and responding to IMF and IBRD pressure, the Marcos administration began to sell non-performing SOEs in 1984. This privatisation was accelerated and widened by the democratic Aquino government. SOEs were hastily sold at the best available price. Others were abolished altogether. An Asset Privatisation Trust was set up to coordinate asset sales and debt-equity swaps.

Bangladesh has been busy privatising for many years. During the 1980s over 1,000 public enterprises were sold (Humphrey, 1990, p160). Sri Lanka is burdened by a large inefficient industrial public sector. The government plans to privatise but is facing much opposition (Cook and Minogue, 1990).

The 'gang of four' have begun selective privatisation. Keen not to spoil a winning formula, the governments pursued privatisation as a means of minimising the effects of the world recession of 1980. **Singapore** privatised not to raise funds but to allow their SOEs to develop further than the government could promote (Low, 1988). The open market was seen as a better breeding ground for new initiatives. Privatisations have included State holding companies, medical and education services and a part of the famous Singapore Airlines. **Korea**, too, has undertaken selective privatisation including the sale of its largest State-owned bank, Korea Exchange Bank in 1990.

There is another Asian country whose economic success is admired by Asia and the rest of the world. The economic miracle of **Japan** has been widely recorded. Japan is not only the world leader in many industrial products but looks set to become the new leader in the privatisation league. In 1983 the Prime Minister's Commission on Administrative Reform recommended criteria for selecting the SOEs to be privatised (Fernandes, 1986, p226). Those targeted were enterprises whose objectives have been achieved or whose existence is no longer necessary. Also targeted were those whose rate of return had collapsed or whose activities could more easily be undertaken by the private sector. Other SOEs may be easily merged with existing private firms.

The world's largest flotation took place when tranches of the Nippon Telegraph and Telephone Corporation (NTT) were sold for Stg£20 billion in 1988. Shares costing Stg£10,600 each were not aimed at the small investor. Foreign investors were not allowed. Nevertheless, the offer was hugely oversubscribed. After one year, pre-tax profits in NTT, now Japan's largest private company, rose by 50% (Higashi and Lauter, 1990, p300). Also sold were the giant Japan Tobacco and Salt Public Corporation in 1985, the government's 34.5% stake in Japan Airlines in 1986 and Japan National Railroads (whose $40 million daily loss had demanded a $4 billion annual subsidy from the government [Higashi and Lauter, 1990, p304]).

VII AUSTRALASIA

The protectionist policies pursued by Australia and New Zealand during the 1970s protected them against the worst rigours of the decade's oil crises. Both countries enjoyed strong growth during the early 1980s. When recession eventually arrived it was harsh. Austerity measures were introduced to curb the nations' rising inflation and spiralling debts.

The Labour government of **New Zealand** has attempted to deregulate the markets. As socialists, it did not wish to pursue policies associated with Thatcherism. In its stead, it adopted what has become known as 'corporatisation'. This allows State bodies to become real autonomous, commercial corporations whose voting rights are retained by the government (Letwin, 1988b). These bodies included Tele-communications, the New Zealand Post and the Coal

Corporation. The move was a form of quasi-privatisation. The corporation pays taxes on profits like any other company and receives no special privileges. The salaries of their managers are linked to the performance of the company (Seirbhis Phobli, Vol II, 1990). The corporations have ceased commercially unviable activities. Heller (1990) reports that corporatisation has improved productivity and lowered costs.

The New Zealand government also oversaw a widespread reform of the public sector including the introduction of user charges, restructuring of health and education services and the reform of pay bargaining (Serbhis Phobli, Vol II, 1990). Sales of the 'corporatised' enterprises began in 1987. The government planned to cut the national debt by one third within five years. Around NZ$3 billion were raised in the first three years. That sum was doubled as a result of the sale of the large Telecom Corporation in 1990 (O'Sullivan, 1990).

Around this time **Australia** also began moves towards divestiture. Before the 1987 crash there were plans to sell leases on international airport terminals. Also planned were the sales of dockyards, aircraft factories, the QUANTAS Airline, Australian Airlines and the Commonwealth Bank of Australia. Apart from a partial sale of QUANTAS to Singapore Airlines, none of the proposed privatisations have taken place.

VIII CONCLUSION

Part Two has surveyed privatisation programmes around the world. It has shown that privatisation for most countries is a part of the restructuring of the economy and, most often, of the diminished role of government in industry.

Privatisation is seen by some countries as a necessary move in restoring flexibility and competition in an economy. Other countries view privatisation as a method of earning revenue to off-set national debts and of shedding loss-making SOEs. Some few countries view privatisation as an ideological tool used to promote capitalism and entrepreneurship.

Globally, the most common forms of privatisation have been contracting-out public services to private operators or the direct sale of State assets to a private firm. Less common, outside of the UK, has been the sale of shares of hitherto public companies to the general public. Other forms of privatisation adopted have been the amalgamation of public companies or their complete abolition.

The effects of privatisation on economies around the world are difficult to measure. For many countries privatisation has helped to lessen the national debt burden if only in the short-term. It has also allowed greater competition and enterprise.

Privatisation can not achieve much alone. If viewed as a self contained policy, an autonomous solution to an economy's inertia, privatisation will disappoint. If seen as a necessary ingredient in a broad policy of deregulation, liberalisation and competition, privatisation becomes a significant tool in combatting poverty, indebtedness and global inequalities. It is yet too early to judge the privatisation legacy. Most national programmes are in their infancy. There are already many cases where privatisation has resulted in former SOEs becoming part of large transnational organisations. And where previously State-owned companies have been bought by large numbers of small shareholders, little time is lost before large chunks of these shares are controlled by large institutional investors. These investors may dictate the company's future policies.

Ireland has much to learn from the privatisation experiences of other countries. It would be wrong for Ireland to wholly embrace or reject privatisation on ideological grounds or on the grounds of short-term revenue gain. Instead Ireland must tentatively assess the privatisation options available in each of the economy's sectors. This assessment is the focus of the next chapter.

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CHAPTER FIVE

PRIVATISATION AND IRELAND

I	Ireland's State-Owned Enterprises
II	Industrial Policy and State-Owned Bodies
III	Public versus Private Ownership
IV	Privatisation to Date
V	Possible Future Privatisations

I IRELAND'S STATE-OWNED ENTERPRISES

The term 'State sponsored bodies' (SSBs) is used thoughout this chapter. It is not a legal term. It is an umbrella term to include the type of companies and agencies that make up the Irish public sector outside of the civil serivice. The term 'State-owned enterprises' (SOEs) may also be used. 'Commercial State sponsored bodies' (CSSBs) are those SSBs whose primary activity is the production or distribution of commercial goods and services. The term 'nationalised industries' is largely inappropriate as few of Ireland's SSBs are State-owned as a result of the nationalisation of existing private companies.

Humphreys and Gorman define an Irish public sector organisation as:

> Any body which: a) directly derives the majority of its share capital from Irish public funds, or b) has the majority of its Board / Executive members appointed by an Irish minister, or c) directly derives the majority of its revenue from Irish public sources (Humphreys and Gorman, 1987, p8).

Irish SSBs may be categorised into four groups (Chubb, 1983, p192; Joint Oireachtas Committee on State Sponsored Bodies (JOCSSB), 1986a; Kelly and Hillery, 1980, pp47-50).

- A 'statutory corporation' is set up by an act of the Oireachtas. Its authority, functions and responsibilities derive from that statute and amendments to it. A statutory corporation is not incorporated as a company under the Company's Acts. Most of Ireland's main utility SSBs are statutory corporations (such as the Electricity Supply Bord and Córas Iompair Éireann). The relevant minister of the government is responsible for the overall direction of the plans of the corporation. The minister appoints a board of management to look after day to day affairs. The minister is responsible for selecting the board's chairperson and the corporation's auditor. The levels and sources of borrowing must also have ministerial approval.

- A 'statutory company' is not set up by statute but envisaged by one. The legislation provides for its establishment and for its duties, functions and powers but the incorporation is a separate process.
- A State-owned company is a company in the ordinary sense except that the majority of the shares are held by the government. Such a company may be State-owned as a result of the nationalisation of a private company (such as Irish Steel).
- Other SSBs are non-trading. Their role is one of advice, planning or research and development. These may be government organised and run, such as Bord Failte and the Industrial Development Authority (IDA), or privately set up and run but largely dependent on government financing, such as, the Economic and Social Research Institute (ESRI) and the Institute of Public Administration (IPA).

REASONS FOR THE ESTABLISHMENT OF STATE SPONSORED BODIES IN IRELAND

The oldest SSBs date back to 1927 when the Electricity Supply Board (ESB), a public corporation and the Agricultural Credit Corporation (ACC), a public company were founded. (Before them was the Post Office but that was a government department until 1984 when it was split into two SSBs, An Post and Bord Telecom Éireann). During the 1930s many more SSBs were founded. They were set up to perform key economic tasks necessary for the development of Ireland's weak, introspective economy. SSBs set up at this time include Aer Lingus, Industrial Credit Co Ltd (ICC), Irish Sugar and Bord na Móna (BNM). Following World War Two, more State companies were founded including An Chomháirle Oiliúna (AnCO) and the Institute for Industrial Research and Standards (IIRS). There were also some nationalisations of important industries such as steel and sea, bus and rail transport. The number of SSBs grew during the 1950s, 1960s and 1970s. Those set up in these decades include Córas Tráchtála, Bord Fáilte, the IDA and the Shannon Free Airport Development Co Ltd (SFADCo). In 1979 the government founded the Irish National Petroleum Corporation (INPC) to protect Ireland aganist further oil price shocks. In the 1980s, as well as dividing the Department of Post and Telegraphs into two SSBs, the government also founded ACOT(Council for Development in Agriculture), Údarás na

Gaeltachta and nationalised three troubled companies, ICI, Dublin Gas and PMPA. Some SSBs whose roles were predominantly advisory were amalgamated or closed. The 1990s have begun with three significant privatisations (Irish Life, Irish Sugar and B & I Shipping Ltd) and the formation of a new Irish Aviation Authority, An Bord Glas, Coillte and the National Treasury Management Agency.

The government became directly involved in industry for several reasons:

- Occasionally (perhaps theoretically) natural monopolies exist where one firm serves the market more efficiently than two. Where this occurs the government may prefer to own and run that monopoly.
- Certain sectors of the economy were deemed to be of vital economic importance but failed to attract sufficient private investment. The government assumed the role of entrepreneur in these sectors (such as electricity supply, telecommunications services and the exploitation of the country's natural resoures such as gas and peat).
- In some cases the government was the only body willing to invest heavily in large capital intensive industries.
- Even where moderate levels of investment were required, the government, alone, showed the entrepreneurial flair to set up and manage commercial companies such as Irish Sugar (Bristow and Tait, 1968, p179). The ICC and the ACC were set up simply because their services were not available in the

private sector at the time (Dáil Debates, 26 Feb, 1991).

- State ownership of companies is sometimes the result of political initiatives. The fear of closure and job losses and the destruction of local economies, force the government to intervene by providing subsidies to the troubled firm, protecting it from competition or by buying it.
- The government may also like to be directly involved in industry in order to direct wage and price policies and help realise its own economic goals. Cromien asserts that Ireland's CSSBs grew as the government sought:

> To find new instruments of policy in grappling with the perrenial problems of developing the country's infrastructure, creating enough new jobs to stem emigration and closing the income differential between ourselves and our main trading partners.... There was no grand design for a 'socialised' economy (Cromien, 1988, p58).

The scope and roles of Irish SSBs are now complex and varied. But the development of SSBs, "has been pragmatic and opportunistic rather than ideological" (Bristow, 1982, p166). Apart from the concerted development drive of the 1930s and the 1960s, the SSBs were founded or nationalised as the opportunity or need arose and not as a result of a long-term tactical development plan. The following list records the reasons for the establishment of specific SOEs.

- The economic priorities during and after World War Two necessitated the setting up of Irish Shipping in 1941 and the nationalisation of Irish Steel in 1947.

- The protection of the railways was a major reason for the amalgamation of a number of private transport companies to form CIE in 1950.

- The protection of investors' funds was a political reason for salvaging the PMPA and Insurance Corporation of Ireland (ICI) in the 1980s.

- The government set up Irish Telcommunications Investment Ltd in 1981 to attract private funds for the massive telecommunications investment programme.

- The maintenance of the Irish language and the protection of its native speakers were reasons for the founding of Gaeltarra Éireann in 1957 and Údarás na Gaeltachta in 1981.

- The National Building Agency was set up in 1961 partly to provide homes for the Garda Síochána (Kelly and Hillery, 1980, p20).

- The Bord Glas Act, 1990 established An Bord Glas (The Horticultural Development Board) to market and develop the horticulture industry (An Bord Glas Act, 1990).

- The Irish Aviation Authority is being set up to develop and coordinate airline services and control.

- The National Treasury Management Agency was established in 1990 to manage Ireland's £26 billion debt (National Treasury Management Agency Act, 1990). By constant renegotiating of loans and by seeking the most favourable interest rates and currency exchanges, the agency can minimise the debt servicing bill. This work was previously carried out by officials in the Department of Finance. However, the expertise acquired by the civil servants made them very attractive personnel in the private fund management market. On average, a principal officer in the Debt Management Office remained only nine months at his/her post before accepting higher pay and greater promotional prospects offered by the private sector (Byrne, 1989). The new, independent semi-State statutory body, released from the recruitment and pay constraints of the civil service, can offer pay and conditions similar to the private sector. The liability portfolio of the new agency is three times greater than the capitalisation of the Irish equity market (Sunday Tribune, 15 Dec, 1991, p36). As Minister for Finance, Albert Reynolds expected the new agency to make savings of £40 million on the annual debt servicing bill (Department of Finance, 1990, p15). The agency is reported to have exceeded those savings in 1991 (Sunday Tribune, 15 Dec, 1991, p36)

For Sean Lemass, the SSBs were an integral part of the development of an internationally trading economy. As Minister for Industry and Commerce, he wrote that, "State financed industries have been set up only where considerations of national policy were involved or where the projects were beyond the scope of, or unlikely to be undertaken by, private enterprise" (Lemass, 1969). He saw efficiency as "the key factor leading to....success" (Lemass, 1969). Although his observations now read, as Bristow says of them, "like descriptions of Edwardian summers" (Bristow, 1982, p167), Lemass was wise enough to warn that:

> There is the danger that after the initial drive to set up an organisation and to get it functioning properly has expended itself, the organisation may settle down to routine operations characterised by excessive caution and loss of initiative and flexibity.... There is a danger that bureaucratic procedures may stifle efficiency and delay necessary and desirable innovation and change. (Lemass, 1969).

Lemass went on to explain that ultimate responsibility lies with the relevant minister and that no difficulties should arise if the board is progressing vigorously and intelligently. He also saw a role for the SSBs beyond their own commercial and statutory duties: "They can, by leadership and example, set standards of performance which can inspire private enterprise to greater achievement" (Lemass, 1969).

Now, more than three decades later, the debate centers around the degree of autonomy that SSBs should enjoy in order that the greater achivements can be realised. Can they be achieved within State ownership or should the SSBs be privatised?

THE ECONOMY, THE NATIONAL DEBT AND THE SSBs

The influences of SSBs on the Irish economy are huge. In 1980 one in ten non-agricultural employees worked for CSSBs. The total number of CSSBs employees was 81,000. Aggregate turnover was £4.2 billion and captial employed was £6.4 billion (Walsh 1987). Shirley's 1983 survey of SOEs throughout the world indicated that Ireland's SOEs' share of GNP at factor cost was, at 8%, mid-table for industrialised nations. The rate ranged from 17% for France to 3.6% for the Netherlands (Shirley, 1983, Table 1, p95). By 1987 Ireland's SSBs contributed 10% of GNP and almost one fifth of the gross capital formation (Sweeney, 1990b, p47). From the mid-1980s until the end of the decade an aggregate loss of £54 million grew to a profit of £228 million. Profits before interest and tax amounted to £395 million in 1987 but the interest payment for accumulated debts seriously reduced the net figure (Sweeney, 1990a). Employment fell by 24.4% during the 1980s (Sweeney, 1990b, p45). In 1989 the total employed was 72,780, about 7% of total employed. Since then employment has risen by about 2,000 (Tansey, 1992). In the year 1989/1990, the State subsidised the commercial semi-State bodies by £114 million and received dividends of £32 million (Department of Finance, 1991, Table 6, p208). Long-term borrowings as a per centage of shareholders' funds (i.e. gearing) was reduced from 592% in 1984/1985 to 322% in 1900/1992 (Tansey, 1992). This remains a considerably high gearing ratio.

The size of Ireland's national debt reflects the size of the country's public sector. "In Ireland the debt problem is the public expenditure problem" wrote Alan Dukes, then Minister for Finance (Dukes, 1986). Although the debt/GNP ratio has fallen from over 130% in 1983 to 102% in 1991, the size of the debt is at a record high of some £26 billion. The EC average debt/GNP ratio is around 60% (Ruddock, 1991). This debt, much of it grossed by SSBs, has many detrimental effects on the economy. In 1987 the public sector owed £3.5 billion, about 15% of the national debt at that time (Halligan, 1987; JOCSSB, 1986). It seriously affects the resources available to the government. Of the £9 billion collected each year in tax revenue, the government can only spend little over £7 billion as £2 billion or more is required to service the debt. Without that burden the government could reinvest the £2 billion and the economy could grow by a multiple of that.

The debt also restricts opportunites for further borrowing necessary for investment in the SSBs. Irish industry, employees and consumers are heavily taxed in order to serivce the debt. This adds to the liabilities of the tax-payer already burdened by a high dependency ratio.

The debt may have significant 'crowding out' effects.

Mulreaney (1988) considered three ways in which the debt may be crowding out economic activity in the private sector. In the first case, the continued high PSBR is using up loanable funds thereby pushing up the interest rate and crowding out private investment. Secondly, a high exchange rate that may result from large public borrowing, can make private sector exports less competitive. Thirdly, public employment may deny expertise to the private sector. It is also apparent that Ireland's high marginal propensity to save (when interest rates are high) and high marginal propensity to import lessen the multiplier effect of public expenditure. The converse of this is that, through privatisation, the crowding out effects are less as the national debt is reduced in the short term. The economy grows as a result.

The large borrowing requirement of the SSBs themselves greatly restricts their investment programmes and their ability to pay dividends to the government. Sweeney explains that the companies are in a "vicious debt-equity cycle where low equity means high debts, leading to high interest payments, which leads to reduced profits" (Sweeney, 1990b, p57). Because dividends are low, the government, as principal shareholder, is reluctant to invest further in the companies.

The concern over the level of public expenditure and debt prompted not only an array rationalisation programmes in the 1980s but also the setting up of the Joint Oireachtas Committee on State Sponsored Bodies (JOCSSB). The committee consisted of several members of parliament empowered to investigate the activities of the State enterprises. But the powers were limited. The committee's reports are little more than synoptical rewritings of the recent annual reports of the examined enterprise. The 1991 Greencore and Telecom revelations illustrate the committee's inability to effectively monitor the activities of the country's State enterprises. These cases are examined later in this chapter.

II INDUSTRIAL POLICY AND SEMI-STATE BODIES

State sponsored bodies have been an integral part of Ireland's industrial policy and economic planning since before World War Two. Ireland, a developing, small, open economy, on the edge of Europe, has relied upon its government, through the State sponsored bodies and government departments, to design, direct and implement industrial policy for general economic well-being. Most SSBs were founded by the State to perform specific, economic and industrial tasks ranging from electricity generation to the exploitation of the nation's fishing resources. In only a few cases did the government nationalise private companies.

The commercial role of the SSBs has been repeatedly sacrificed for the sake of general industrial policy. That policy has matured from the myopia and insecurity of the Economic War with Britain in the 1930s, through widespread industrialisation and favouritism towards foreign industry, to today's considered industrial approach that combines incentives for foreign firms with generous support for indigenous industries.

Since 1958, Ireland's industrial policy has shed the protectionist rules of the preceeding decades in favour of industrialisation and the promotion of foreign inward investment. Foreign companies were attracted to Ireland through the State-owned IDA. The attraction lay primarily in the export sales tax relief available to them. The firms, mainly from the USA, also received an array of grants for such things as fixed assets and training. Another key attraction was the free depreciation allowance. Irish firms whose products were mainly for export, also received many of the same incentives. This policy was successful in attracting many new foreign firms into Ireland. By the time Ireland joined the EEC in 1973, manufacturing output was 2.5 times its 1957 level and employment had grown 30% (Ruane, 1984). By EMS membership in 1979, the amount employed by American firms was greater than that employed by any other group of foreign investors. In general, 74% of exports in 1979 were by foreign firms (NESC, 1981, Exhibit D).

The Telesis report of 1981 criticised Ireland's industrial policy of the 1960s and 1970s for being overly generous. Of the 60 foreign electronics firms surveyed, none had a truly stand alone operation in Ireland and only three performed the key part of their manufacturing within Ireland. The report said that Ireland was giving away too much in the form of grants as the 10% corporate profit tax rate was the fundamental attraction and enough in itself. This 10% corporate tax rate, a refinement of the earlier export sales tax relief, has also been abused. Foreign firms may underprice their inputs and overprice their outputs in order to exaggerate the value added by their Irish operations. This qualifies more of their profits to be subject to the 10% tax.

Despite the rise in foreign industrial output in Ireland, the 'linkage effect' with Irish industry has been poor. O'Malley (1989) estimates that in 1984 net output per person employed by Irish owned firms was worth £17,000 while the net output per person employed by foreign owned firms in Ireland was worth £42,500. Another disappointment of the industrial policy pointed out by Telesis was that only 30% of jobs approved by the IDA in foreign firms in the 1970-1978 period were still there in 1981. For the indigenous sector, the job survival rate was even worse at 14% for the same period.

The Telesis report, apart from calling for a reduction in industrial grants, recommended that greater emphasis be placed on indigenous industry and on the electronics industry in particular. It also called for a detailed strategy on economic development and growth. The base of such a strategy is already there in the form of the IDA and the SSBs. On this point the report generalised:

> The State sponsored agencies concerned with industry impressed us, in most cases, as being extremely well run organisations.... The level of motivation is high... There is undoubtedly in Ireland a degree of common purpose regarding industrial development that is rarely found in other countries. (NESC, 1982, p186)

The government's response to the Telesis report and its version of a 'common purpose', was the White Paper on Industrial Policy of 1984. It welcomed the recommendations of the Telesis group and sought to adopt many of them. The emphasis switched, as Telesis proposed, towards indigenous, Irish manufacturing firms whose output contains a high value-added element and is designed for export. Although it abolished re-equipment grants, it replaced them with a more generous but similar, technology acquisition grant. The Paper planned to reduce the overall level of grant aid. But the new grant aid would be available not only to exporting firms but also to those involved in import substitution. The IDA was instructed to be far more particular in choosing companies for aid. It was asked to target potential winners from within the set of small Irish enterprises. Those targeted should receive considerable aid and assistance and, "work on an intensive basis with the appropriate State agencies" (Stationery Office, 1984). Incentives should only be given to those foreign firms who perform key functions in Ireland and who retain some profits within Ireland. There should, too, be a development of linkages between foreign and indigenous firms.

The rhetoric of the White Paper was an apparent shift towards Irish owned aspiring industries but the policy changes were cosmetic. Even if the policy change had been more substantial, the possibility of implementing it effectively was remote. On the IDA's new role, Lee (1989, p536) writes that at the time there "was widespread scepticism about the capacity of the government to pick even a solitary winner... both on the grounds of its technical competence, and of likely corruption."

The White Paper referred to greater worker participation in decision making and a lesser reliance on State agencies for aid and direction but made no reference to privatisation of State-owned enterprises. Instead it called upon them to meet an improved rate of return. They were criticised for their inability to manage and direct themselves. Their poor and deteriorating performance was blamed not only on the recession but on their lack of planning, poor investment decisions and, "their excessive reliance on guaranteed borrowing" (p84). The Paper (pp90-99) planned to set up a National Development Corporation (NDC) that would initiate and coordinate new commercial activities in the private and public sectors. According to the Paper, the principal role of the public sector is to foster growth in the private sector.

The government's plan for 1985-1987, Building on Reality, claimed that one problem for SSBs has been the, "lack of clear definition by government of the strategic, economic and social roles of State enterprises and failure to develop accounting arrangements and performance targets which would enable government to appraise the results achieved by public enterprises against agreed policy requirements" (Stationery Office, 1985a, p68). The plan, however, failed to define any new, clear, long-term strategy. Instead, it called for a 5% reduction in public sector employees during the period of the plan. It supported the White Paper's suggestion of a National Development Corporation to give new commercial and strategic thrust to public investment in industry.

Also in 1985, a White Paper on the public service, Serving the Country Better, specified the needs for improved management and greater personal responsibility (Stationery Office, 1985b).

The Programme for National Recovery (PNR) was the government's plan for the period 1987 - 1989. Its compreh-ensive aims were:

> Lower interest and mortgage rates, a stable exchange rate, low inflation, stabilisation of the national debt-to-GNP ratio and its subsequent reduction to a sustainable level, halting and reversing the flow of capital out of the economy and lower and more equitable personal taxation (Stationery Office, 1987, p16).

The SSBs were, "actively encouraged... to develop and diversify their economic employment creating activities" (p17). State agencies were asked to develop their overseas consultancy work, in particular (p25). An appendix to the plan listed the job creating projects proposed for the larger State-owned enterprises. These included ten small scale hydro-electricity installations for the ESB, 8,600 additional hectares of bog lands for Bord na Móna, a trebling of the country's output of farmed fish for Bord Iascaigh Mhara, aviation reinsurance for Aer Lingus and the "possible development of banking and retailing services" (p31) for An Post. Around this time, Albert Reynolds, then Minister for Industry and Commerce, declared that, "the government is simply no longer prepared to make up for any failure by CSSBs either to contain company costs or to generate funds needed for investment." (Business and Finance, 26 Nov, 1987, p3)

The PNR received widespread support and was executed precisely. The National Economic and Social Council credited the plan for its, "consistency, continuity and credibility" (NESC, 1990, p2). It helped to create a "virtuous cycle" (p81) of falling interest rates that facilitated improved public finances, leading to further falls in interest rates.

Ireland's economic performance during the 1987/1990 period was impressive. The general consensus and application of the PNR aided a concerted effort to stimulate the economy. GNP rose by over 3% pa during the period 1987/1989 and by 7.0% in 1990 despite the government's tight fiscal rectitude and the recessions in the UK and the USA. That growth rate compares to an average 0.2% rise pa for years 1980/1986 (NESC, 1990). McAleese referred to this period as one of, "expansionary fiscal contraction" (Barrett, 1991).

The ratio of Ireland's national debt to GNP, fell from a high of 131% to just over 100%. In each of the years 1987, 1988 and 1989, the actual EBR (exchequer borrowing requirement) was less than the level planned by that year's budget (NESC, 1990, p40). Disinflation also ocurred as both inflation and interest rates fell (although the later fell only slightly). Unemployment, though, remained high at around 240,000. (Ireland's battle against unemployment is partly restrained by the link between it and emigration. Improvements in employment opportunities decrease the push factors that cause emigration. As emigration falls, the workforce expands and the unemployment rate remains high.) Inflation is well under control and near the lowest in Europe. Ireland's balance of payments has remained in surplus despite the continued haemorrhage of net factor income from abroad. (The underlying balance, though, is a £700 million deficit but this is swallowed by the £1.6 billion net transfers from the EC). The size of the surplus is also affected by the degree of transfer pricing by multinational firms.

Ireland has not lost its attractiveness to foreign investors. Peter Ballinger, writing for Business America in 1988, included as advantages for foreign companies investing in Ireland, the country's financial incentives, the tariff free access to the EC and the country's highly skilled, low cost, young labour force (Ballinger, 1988). The Review of Industrial Policy 1990 by the Department of Industry and Commerce, reported that the profitability of foreign firms (before tax) as a percentage of sales grew to a 24.1% in 1987. Indigenous firms doubled their profits but only to 3.9% in 1988 (Dept of Industry and Commerce, 1991, Table 3.7). It justified the continued grant support for foreign investment in Ireland but reassured that, "State financial support for inward industrial investment is not given at the expense of support of the development of the medium/large indigenous sector which is the primary focus of industry policy" (p66). The IDA claims that during the period of the PNR, 60% of sustained first time jobs created by IDA backed companies were in Irish owned enterprises (IDA, Annual Report, 1990). The Culliton Report of 1992 (by the Industrial Policy Review Group) asserts that the Telesis recommendations have not been fully impemented and that selectivity of grants has not been improved (Culliton, 1992, p66). This report recommends, as the JOCSSB had done in 1986 (JOCSSB, 1986a), that equity not grants should be offered. The IDA should become 'aggressive venture capitalists' and concentrate its promotion on 'clusters' of related activities (Culliton, 1992, p72).

A NESC report of 1989 concluded that since joining the EEC, Ireland's economic performance "compares unfavourably" with other member states (NESC, 1989, p523). Income and consumption grew less than the European average and Ireland's unemployment rate remains the highest.

A NESC report of 1990 expressed optimism about Ireland's immediate economic future. The report estimated that growth will average 3.75% pa in the years 1991-1994 (NESC, 1990, p84). Employment will rise by 9,000 per year while emigration will continue to fall. Unemployment will fall a little. The national debt / GNP ratio will fall below the

100% mark by 1994 as the EBR approaches 1% of GNP. These promising projections were subject to no detrimental changes in oil pricing, exchange rates, interest rates and developments in the GATT negotiations. The report also assumed that the economy will continue to experience the tight budgetary control and wage moderation that characterised the latter part of the 1980s. The report is sceptical about the benefits of privatisation. It warns that where market inefficiencies are dominant, private companies are no more efficient than public ones (NESC, 1990, p364). Privatisation is an "inappropriate policy" (p373) where there is no competition in product markets.

Budgetary control is the focal point of the government's present economic plan, Programme for Economic and Social Progress (PESP). It plans to cut the national debt / GNP ratio to 100% by 1993 and to 75% by 2000. Wage moderation is again a key element. Yet, the same programme is very generous in its public sector pay increases if existing pay awards and agreements are taken into account. Teachers, for example, will receive an average 20% pay rise during the three year period of the programme.

Under the PESP, the corporate tax rate for exporting firms remains at 10% but is extended by PESP to last until 2010. Foreign firms operating in Ireland now employ almost 90,000 people, one in four industrial workers. They spend £3.5

billion each year in the Irish economy (Stationery Office, 1991a, p45). Industrial policy will continue to support exporting firms and those involved in import substitution. The continued policy drive will be supported by Coras Tráchtála which has merged with the Irish Goods Council to form An Bord Tráchtála (p46). The overall aim of the Programme is to "maintain a low inflation economy with a stable exchange rate which can compete internationally" (p5).

The Programme makes few references to privatisation. The plan for a "cohesive strategy for supporting voluntary activity" in the area of social reform, could be seen as privatisation by stealth. That is, the private sector is being asked to voluntarily produce services usually produced by the public sector. The proposed increase in private toll roads may be seen as another example of this. The Programme encourages general worker participation in the management of companies.

On the ownership of SSBs, the Programme says that changes in ownership "will only take place if it is in the public interest and in the best interest of the company and its employees and following consultation with the social partners" (Stationery Office, 1991a, p58). Clearly, privatisation is not ruled out. The Programme says that the government has "no ideological position" on the matter of privatisation (p59). In 1990 Seamus Brennan, then Minister for Tourism and Transport, outlined the government's view that:

> What is important is that they (the SSBs) work and that they contribute to economic activity and growth and that they compete fairly in the open market... The government has and will retain or dispose of SSBs on a practical, case by case basis. (Brennan, 1990, p3)

It seems likely that privatisation, like nationalisation before, will proceed in a piecemeal, irregular fashion. On balance, this practical approach is better than a privatisation programme driven by ideological fervour. It is right that an Irish government consider the privatisation of individual SOEs based on the particular circumstances of each case.

The Industrial Policy Review Group also recognise the need for the CSSBs to be allowed to operate "in a fully commercial manner...without undue bureaucratic constraints and political intervention" (Culliton, 1992, p75). The group's industrial strategy for the 1990s criticises the degree of both cross-subsidisation and of State subvention in the public sector. It says that the levels of subvention should be announced and, with that information, competitive bidding should be allowed. The group welcomes more joint ventures with the private sector but insists that "improved efficiency need not await privatisation" (Culliton, 1992, p76).

Since the PESP agreement in early 1991, the economy has returned to the unwelcome cycle of rising unemployment, rising inflation, rising public sector pay and rising EBR. Unemployment exceeds 270,000 (20% of the workforce). Tax revenue is less than anticipated. Inflation, though low, is rising slowly (Congress of Irish Industry, 1992). Public sector pay is set to reach £3,500 million pa. The EBR, cut from 12.8% in 1986 to 2.1% in 1991, may creep to 3% for 1992 (Bradley, 1992). The Central Bank estimated that the economy may have grown by just 0.5% in 1991 (Central Bank Quarterly, Autumn, 1991). The Economic and Social Research Institute (ESRI) estimated growth for 1991 at 2% (ESRI, 1991). The implications of the PESP, the CAP reforms and of the UK and US recessions have renewed the focus on government expenditure. It is against this backround that the privatisation programme must perform.

The PESP clearly lacked the consistency, continuity and credibility accredited to the PNR. The PESP threatens to restore the vicious cycle of rising labour costs, inflation and low growth.

Policy decisions, including privatisation plans, must be made in the context of Ireland's economic performance and position in world trade. Ireland remains a heavily indebted nation, a small open economy dependent on international trade for its own growth. The emerging Single European Market will present new challenges to Ireland. Companies, whether publicly or privately owned, may be threatened by take-overs as industries consolidate to exploit the new opportunities. As competition is intensified, the government will need to strengthen the regulation of dominant companies. But such regulation will be restricted by the European Commission. Simultaneously, State ownership of enterprises may be challenged as competition is opened to international, private companies. For the sake of fair competition, member states of the EC may be prohibited from owning direct stakes in industrial companies.

III PUBLIC VERSUS PRIVATE OWNERSHIP

Chapter One explored the arguments for and against the privatisation of State-owned enterprises. This section of Chapter Five reviews some of these arguments and applies them to the Irish context.

Direct State involvement in industry can lead to a dichotomy. The government is faced with mixed responsibilities. It is the entrepreneur, the owner and the public watchdog. It is the regulated and the regulator. This conflict can lead to mismanagement and miscontrol. Even when the relationship between the government and the management of the company is at arm's length, it can never be truly independent. O'Callaghan called for a statutory independent assessment agency to "promote a better motivational mix and promote consensus by producing more accurate and relevant information and by providing a window into the organisation" (O'Callaghan, 1984, p354). There already exists a number of controls. Most of these are ministerial. The 1991 Greencore and Telecom affairs suggest that the ministerial control is rather less intrusive than it should be. For years, ministers and governments have tried to remain distant from the day to day affairs of the company, thereby approximating a truly commercial environment. However, there is a need for the minister to be fully aware of all investment plans and strategies of the company.

The Joint Oireachtas Commitee on State Sponsored Bodies is ordered to make "recommendations on matters such as the structure, organisation, accountability and financing of commercial State bodies, and on their relationship with central goverment and the Oireachtas" (JOCSSB, 1986a, p1). But the committee's powers are insufficient to detect organisational ineffectiveness or the misallocation of resources. There is no single body in Ireland that thoroughly and regularly examines the performance of SSBs in the areas of consumer relations, the quality of goods or service and the conditions of employment and remuneration.

Two other Oireachtas committees specifically examine the expenditure and accounts of all government departments. The 1985 White Paper on the Public Service, Serving the Community Better explains that the Committee of Public Accounts examines the "appropriation of the sums granted by the Dail to meet public expenditure". The Committee on Public Expenditure must "review the justification for and effectiveness of ongoing expenditure of government departments and offices" and of non-CSSBs (Stationery Office, 1985b). It has only been another government policy that has indirectly brought an improvement in the financial position of some SSBs. The severe contractionary fiscal policies of the governments of the last ten years did most to restore the SSBs to a better financial standing. Proposed privatisations may further that improvement.

Privatisation has begun in Ireland. During 1991 54.5 % of Irish Sugar was sold for £63 million and 55.5% of Irish Life grossed £270 million. The sale of B&I to Irish Continental Group for £8.5 million was almost complete. The 1990 budget had earlier referred briefly to the government's intention to build a five year privatisation programme during which several State companies will be sold wholly or in part with the single purpose of reducing the national debt. The Minister for Finance proposed that £50 million would be the average annual revenue from sales during the period (Budget, 1990). The two flotations of 1991 alone grossed the total for the five years.

The central and immediate attraction for the Irish government is the revenue that privatisation can raise. This revenue can reduce the PSBR or directly contribute to servicing the country's massive national debt. By the total sale of five or six of the country's largest State-owned enterprises, £2,500 million can be raised. Already £333 million has been grossed from the part sale of Irish Sugar and Irish Life.

It is important to remember that privatisation is itself a form of borrowing. The value of an SSB is, in theory, the net present value of its assets and its future profits. A profitable SSB is more valuable and will sell for a higher price than a less successful SSB. A loss making SSB could, in theory, be given away as it is worthless in short-run investment terms. Or it may be sold for a small sum that reflects the value of its assets. In 1990 the government considered the sale of the loss making Irish Steel for just £1 (one pound) (Business and Finance, 16 Nov, 1989). In the case of the loss making SSB, the government appears to benefit from a sale but may have a long-term expense of social welfare payments to the workers laid off by the privatised firm and possible subsidies paid to the firm in the short run as well as the high cost of the privatisation itself. In the case of a profit making SSB, the government and the taxpayer, although earning a considerable windfall for now, lose out on the profits of future years. It is the same as borrowing. You receive a large sum now but pay for it over a number of years. In this case privatisation does not lessen our national debt. The exchequer may only gain if the value of the State enterprise that is set by the private sector is greater than the net present value of its future incomes.

There may be a different type of benefit from privatisation. If, as is hoped, the constraints, demands and expectations of the open competitive market improve the efficency and profitability of the privatised firm, the government gains from increased tax revenue and general economic growth. The

consumer benefits from increased competition, better choice and improved quality that follow the privatisation.
The above proposition assumes that privatisation will increase competition. Chapter Three investigated many examples of British privatisations that lead to no significant improvements in competition. In some cases privatisation merely transformed a public monopoly into a private monopoly. The massive profits earned by British Gas, BT, BAA, BA and the Water and Electricity companies, all of whom retained many monopoly powers after privatisation, illustrate that competition and consumer choice do not follow directly from privatisation. Besides, improved efficiency and wider competition are possible even if the company is retained within the public sector. The image of public enterprise management as ineffective and inept is ill-conceived. Chapter Three recorded several cases in Britain where the efficiency and profits of firms about to be privatised improved significantly before the privatisation took place. The subsequent performance of the privatised companies were the result of an earlier trend. The Irish government should not see privatisation as the only way to improve the efficiency of State companies.

A different reason for withdrawing from direct State ownership in industry may be the desire to lessen government intervention in the market-place. This motive was a significant one in Britain in the 1980s. Less government interference allows more individualism and more freedom, according to this argument. Yet privatisation may lead to more not less government interference. This is particularly so when large, monopolistic utilities are sold whole. They require a lot of public regulation to ensure that they do not unfairly exploit their monopoly position. Less direct government involvement in British industry in the 1980s has resulted in complex government regulation. Watchdog agencies such as OFFER, OFTEL, OFGAS, OFWAT and the Monopolies and Mergers Commission are required to safeguard the consumers' and the nation's interests. McDowell fears that government regulation may be "at least as likely to be a device to diminish competition and enhance rents as it is to be a method of safeguarding the public interest" (McDowell, 1987). That is, the government's role as regulator may repeat all the alleged errors of its former roles as owner and manager.

Privatisation may be supported because it lessens the crowding out phenomena that can result from excessive State intervention in the economy. This chapter has explained that large State-owned enterprises can crowd out private participation in the exporting, employment and capital sectors. By reducing government involvement, through privatisation, and by breaking up large companies, these effects can be reduced.

Privatisation may itself cause another form of crowding out. If large flotations are carried out they will attract large amounts of private investment funds. This may exhaust the amount of funds available for other investment opportunities. In this way necessary, private investment progammes may be starved of funds. Money is going, instead, towards a non-productive transfer of ownership. This money, if used to service the national debt, becomes a leakage in the system. It is a shift from investment to debt repayment.

Privatisation may be supported in Ireland because it subjects SSBs to the scrutiny of the stock exchange. The pressures of the sale performance and the subsequent pressures of shareholders force an SSB to improve its managerial and productive efficiency. This will be particularly welcomed in monopolies such as the ESB and BNM, whose activities have not been subject to thorough and constant scrutiny. This will help to highlight difficiencies and pinpoint areas requiring restructuring.

This examination is possible without privatisation. The government can keep the company within the public sector but introduce a comprehensive regulatory board whose powers are much wider than those of the Joint Oireachtas Committee on State Sponsored Bodies or the Committee of Public Accounts. It is likely that in the event of privatisation such a regulatory body will be required. The Greencore and Telecom debacles are forcing the government to re-examine the effective controls of all activities of SSBs.

Large companies require large investment programmes to maintain or increase their market share and to improve their productivity. Privatisation allows State firms to gain access to private funds through the stock exchange. It also relieves the government from the burden of injecting scarce public funds into the long-term, expensive projects of the large SSBs. It is essential that Ireland's large companies, public or private, invest properly in preparation for the Single European Market. Privatisation may facilitate this investment. Sweeney (1990b) describes the government's investment policy as 'perverse' because the government tends to invest heavily only when an SSB is in dire need (such as B&I and Irish Steel in the past) and not when it is growing and profitable.

The Irish Congress of Trade Unions recognise this need for increased investment. Although the Congress opposes the privatisation of utility companies (such as the ESB), it is open-minded about the partial privatisation of other SSBs. Congress insists, though, that the government maintain a majority stake in these companies and that revenue from the sale be reinvested into the company rather than used to lower the national debt (Business and Finance, 1 March, 1990, p34).

The benefit of increased investment opportunities that may result from privatisation can be qualified by two important points. Firstly, privatisation not only frees companies to attract investment funds but opens them to the threat from foreign predators. As the EC strengthens political and economic union, the consolidation of European companies is likely to be transnational. There are already many examples of mergers and take-overs that have resulted in larger and stronger European companies. Nestlé's expansion is an example of this. Such mergers and threats of mergers may themselves be good in efficiency terms. The threat of the take-over encourages firms to be efficient in order to maximise their value and, in this way, offset a future threat. This take-over threat may be strong enough to ensure efficiency even in companies that are local monopolies. Julian LeGrand explains that the "ever present threat of a take-over bid will provide a strong incentive for managerial efficiency" (Le Grand, 1988).

Take-overs may compromise a nation's sovereignty. Privatisation may be a first step in losing national control of a company. It may also result in asset-stripping whereby the profitable parts of the business are separated from the loss making parts. These latter parts are closed down while the profitable parts are sold as parts and for huge gains.

For these reasons, it is necessary that the Irish government maintain at least a special share in major companies that are privatised. The 'special' share can then be used to prohibit both foreign control and a breaking up of the company. (On the other hand, as Ireland forms part of the Single European Market, she may gain from a general increase in efficiency. The location of ownership, therefore, may become irrelevant.)

Secondly, private investment in public enterprises can be possible without privatisation. A joint venture project is a way of maintaining public control in a company while exploiting private investment funds. Such joint venture funds are now common. Nitrigin Éireann Teoranta (NET), the State-owned agricultural chemical company has formed a joint venture with Richardson's Fertiliser, a Northern Irish subsidiary of Britain's ICI. Telecom Éireann produces a number of services through joint ventures with private companies. Such joint ventures allow an Irish State company to gain access to private funds. The Review of Industrial Policy by the Department of Industry and Commerce encourages State enterprises (specifically Aer Lingus, ESB, Irish Sugar and Aer Rianta) to seek private venture partners (p62). Other joint ventures include the construction and management of toll bridges and roads. In France, where privatisation in the form of share flotations is no longer allowed, investment starved SSBs such as Renault, are proceeding with massive joint ventures with private, sometimes foreign firms.

Solomon Abrahamson & Co (1990), in a study of the implications of privatisation for the Irish economy, explored the likely effects of a large flotation on Irish interest rates, liquidity and public finances. The effects depend on whether the puchasers are domestic or foreign and how the revenue is spent. If an SSB is sold to foreign purchasers and the revenue is used to cut taxes, to increase spending or to cut the domestic element of the national debt, the sale will result in an increase in liquidity and reserves, and in a fall in interest rates. There will be no net improvement in our public finances. (The improvement in the balance of payments brought about by the inflow of capital to buy the shares will be reversed in the long-term as dividends on profits cause an outflow.) If the money raised from a foreign sale is used to cut the foreign element of the national debt there is no improvement in liquidity, interest rates or public finances. It is, in effect, a debt-for-equity swap. The nation foregoes future revenue gains for the sake of a current windfall. If the sale of shares is to domestic purchasers the effects are again a temporary windfall of revenue without future gains in liquidity or public finances. The revenue raised from the domestic sale could be used to cut domestic debt but this, too, is a debt-for-equity swap.

OTHER FORMS OF PRIVATISATION

The goals of privatisation, whatever its form, should always be practical rather than ideological. The chosen policy should only be pursued if there is outstanding revenue gains for the government. These gains, however, will not suffice if there is a considerable loss in the quality of the service produced. Social and cultural costs and gains should be considered together with financial rewards. In no case should the aim to reduce the nation's debt be allowed to outweigh other long-term social, cultural and financial costs.

There may be opportunities for other forms of privatisation in Ireland. Increasingly, activities at one time viewed as the responsibility of the government, are being carried out voluntarily within the private sector. Charities, clubs and other voluntary agencies have a central role in combatting social ills such as poverty, homelessness, loneliness, ill health and crime. By withdrawing State support in these areas, the government is privatising the provision of these services.

Contracting-out is not a widely used method of providing services in the Irish public sector. It involves the government paying a contractor to produce a service. The contract must include incentives designed so that managers, to maximise their objectives, must maximise the objectives of the government (McDowell, 1987). A contract is only worthwhile if the fee paid to the contractor is sunstantially lower than the cost of direct public production of the service. Ideally, contractors competitively bid for the fixed price incentive contract (see Chapter Two).

There are many opportunities for contracting-out work to the private sector. These range from cleaning and laundry services to private tax collection or airport security. The cost of the contracting-out process may be far more than the payment to the contractor. If the service is contracted to private firms, there is the considerable cost of the redundancy or redeployment of the public servants who did the work until now. There is also the cost of regulating the contractor. There may be the social cost of a job poorly done by a profit maximising contractor. An Irish government must consider all of the financial costs and all of the social benefits and losses. When these indicate that contracting-out is beneficial to all, this policy should be pursued.

Ireland should also examine opportunities for franchising services to private companies. A franchise is a licence to produce a particular good or service and can be awarded through the competitive bidding process. The winning franchisee pays the government for the licence and the consumer pays the franchisee for the good. The government continues to ensure the provision of the good but licences a private firm to produce it. The threat of withdrawing the franchise licence should encourage the firm to operate efficiently. It would be inappropriate though, for the government to franchise large monopoly powers. Transplanting monopoly rights from the public to the private sector will not result in increased competition and will necessitate comprehensive regulation.

Increasingly, consumers are switching their purchase of goods and services from the public sector to the private sector. As the populace becomes more affluent, public services such as education, health, dental and ophthalmic care are being substituted by similar private services. This is privatisation by stealth. Another example is a reduction or abolition of grants and subsidies. This chapter has already outlined the trend in Ireland's industrial policy towards the reduction in grants to industry. This reduction is a lessening of the State's financial involvement in industry. Firms must turn to the private sector for investment and for improved management and production techniques. Ironically, increased subsidisation is a likely short run consequence of privatisation as the government increases aid to State companies before, during and immediately after their transformation into private companies.

The above approaches are forms of deregulation. They allow industry to operate more competitively and more freely. They are designed not only to reduce the government's financial burden of direct involvement in industry but also to maximise efficiency so that consumers and the economy gain.

Chapter Two distinguished these forms of deregulation from another type of privatisation, divestiture. The forms of deregulation mentioned above do not alter the government's role of provider of certain goods and services. Divestiture can alter that role. It is this form of privatisation that is most widely discussed. This chapter will continue to highlight an important aspect of this study. That is, that deregulation may not be as radical as divestiture. Deregulation can take place without altering the government's ownership of the SSB.

Ironically, abandoning government ownership of a State-owned company may not result in any deregulation of the industry. Chapter Three explored the many cases in Britain where privatisation meant little more than the transfer of ownership of a monopoly from public to private hands. It is essential that the Irish government and the Irish people see divestiture as only a part of the deregulatory process. It is not an end in itself. Comprehensive and well judged legislation will be necessary if the government wishes to introduce liberalisation and competition into those industries currently dominated by SSBs.

The Irish government has made it clear that any revenue gains from privatisation will be used to reduce the national debt. A temptation may be to maximise revenue by selling large monopolies whole rather than in parts. A fragmented monopoly is not worth as much as one intact. But the sale of a monopoly does not improve competition or efficiency. Instead, it will require an elaborate State controlled regulatory system to ensure that the privatised monopoly does not exploit its position. The experiences of the British regulatory bodies created after privatisation, do not offer much confidence that Irish regulation of monopoly power will be successful. OFFER, OFGAS, OFWAT and OFTEL have achieved little success in promoting widespread and open competition in their respective industries.

If the government opts for divestiture, there are a number of options. (These are explored fully in Chapter Two.) An SSB could be sold directly and in whole to an existing private firm i.e. a trade sale. The SSB could be sold directly to management or to employees or both. The SSB could be sold to a large number of shareholders through a private placing or through a general flotation.

There are few indigenous Irish businesses large enough to buy an existing SSB outright. A direct trade sale is unlikely to occur except where the buyer is a foreign firm. There are some examples of trade sales in Ireland. The short lived nationalisation of PMPA ended when it was sold to Guardian Royal Exchange. The Great Southern Hotels Group was sold to Aer Rianta. (This was not a privatisation since Aer Rianta is itself a State-owned company.) More recently, B&I has been sold to Irish Continental Group.

Employee and management buy-outs are possible options for the future. They entail a great amount of legislation and preparation. The Worker Participation (State Enterprises) Act 1977 and 1988 established worker participative structures in State-owned companies (Business and Finance, 21 Feb, 1991). The 1991 PESP commits the ICTU and the FIE to examine the issue of worker participation in industry (Stationery Office, 1991a). The proposed joint report may be a useful guide for future EBOs and MBOs.

A second tranche of Greencore was unexpectedly sold by a private placing in February, 1992. That is, a block of shares in the company were sold by the government to regular customers of one or more stock brokers. This method of sale is likely to occur in Ireland only when a small amount of shares are to be placed.

Irish divestiture programmes are most likely to follow the flotation method. The two privatisations of 1991 were flotation sales. The Irish Stock Market, however, can only cater for one large flotation at a time. A flotation of a company like Telecom Eireann will need to attract a large number of foreign investors. The 1991 Greencore and Telecom controversies may discourage such foreign investors. Potential shareholders may fear that the SOE about to be privatised may have an undisclosed history of mismanagement or may be corrupt or fraudulent in some way. Government ministers and departments and professional consultants all failed to discover or failed to reveal the concealed activities of the companies. None of the recent inquiries into the Greencore and Telecom controversies have done enough to allay these potential fears.

A flotation sale could set the price of shares through competitive bidding or be fixed price. The fixed price flotation is the simpler to arrange. It attracts the small and large investor. It is clear and unambiguous. Its attraction, the fixed price, is also its greatest burden. Choosing the right price is a difficult task. It must be a price that accurately reflects the value of the company. The price must be attractive to shareholders allowing them to earn at least a small premium. If the government sets the price too high the privatisation programme as a whole suffers. If the price is too low and huge premiums result, the government's stewardship of people's assets and its aim of maximising revenue are not fulfilled.

The problem of selecting the best share price may be overcome by three sales options. The sales of Cable and Wireless and BP in Britain illustrate how the fixed price method can maximise revenue and eliminate the risk of erroneous pricing through the sale of tranches of the company over a long period of time. Having tested the public's interest in the company at the time of the first tranche sale, the government can adjust, usually upwards, future tranche prices and thereby maximise revenue.

A second way of overcoming the difficulties in setting share prices is the sale through competitive bidding. This allows the government to accept the highest price offered for groups of shares. But this method is bureaucratic and too complicated for the novice share purchaser.

Thirdly, the government could announce not the price of the share but the value of the premium that is guaranteed on the day of sale. In this way the government does not announce the share price until the day before the flotation. This method of pricing is only possible where the company has already been part-privatised or its shares are already trading in the market. It is likely that the Irish government will continue to privatise using the fixed price method adopted for the sales of Irish Life and Irish Sugar. These sales are examined below.

IV PRIVATISATIONS TO DATE

The 1990 budget was the first clear statement of the government's intention to privatise some of the nation's State-owned enterprises. It proposed a five year privatisation programme with the specific aim of lowering the national debt (Department of Finance, 1990).

The Review of Industrial Policy 1990 by the Department of Industry and Commerce (1991) indicated two areas where the government is to further withdraw its direct involvement. The grant system is to be further curtailed with more cuts in grants to foreign companies operating in Ireland. There will be "further rationalisation" of State agencies involved in industrial promotion. This is likely to take the form of closure or merging of agencies. Recent examples of amalgamations of State agencies are:

- The joining together of the Institute for Industrial Research and Standards (IIRS) and the National Board for Science and Technology (NBST) to form Eolas.
- AnCO (The Youth employment Agency) and Manpower merged to form Foras Áiseanna Saothar (FÁS).
- Teagasc was created by the merging of ACOT and the Agricultural Institute.
- The government current economic plan, PESP, proposes the merging of the Irish Goods Council and Coras Trachtala to form An Bord Tráchtála.

There are a few examples of privatisation before the recent sales of Irish Sugar and Irish Life. In 1972 the assets of the Dairy Disposal Company were sold to the North Kerry and Golden Vale Co-ops (Durgan, 1989). That was an example of a trade sale. Another was the 1983 sale of PMPA to Guardian Royal Exchange. When the government liquidated Irish Shipping one of its subsidiaries, Irish Continental Line, was privatised. A different type of privatisation took place when NET and the then private ICI together formed Irish Fertiliser Industries. This joint venture is an example of the type of opportunity available when public and private firms invest together in new, sometimes risky, projects. The quiet sale of council houses to former tenants is another form of privatisation since public financing is replaced by private investment.

A different example of State withdrawal from industry occurred occasionally throughout the 1980s when the government liquidated Irish Shipping, Ceimicí Teoranta and ended the operations of Fóir Teo and An Foras Forbartha.

THE CASE OF IRISH SUGAR

The first modern style flotation of an Irish SSB was the flotation of Irish Sugar in April 1991. The sale of 54.5% of the country's only processor of beet sugar grossed £63 million for the government. A further £22 million was raised for the company through a rights issue that corresponded with the flotation.

Comhlucht Siúcre Éireann (Irish Sugar Company) was set up by the qovernment in 1933. It began operations by acquiring a Carlow sugar factory that was founded in 1926. The new company soon built other factories in Mallow, Tuam and Thurles. These developments, along with the founding of other important SSBs during that period, were part of DeValera's plan as he said, of "making the way for a self sufficient and self supporting State" (qouted in The Sunday Business Post, 21 April, 1991, D6). Equipment for the new factories was imported, mainly from Germany, and partly paid for with Irish cattle. By the second World War, the company was large enough to supply Ireland with its sugar needs. After the war the company diversified a little to fertilisers and food production. Erin Foods, for example, was founded by the company in 1961. The company overcame the cost of special beet harvesting and manufacturing equipment by designing and making its own.

During the decades that followed Irish Sugar continued to expand production and develop its food production activities in particular. It acquired Mattersons, a food company, in 1968, Trilby Trading, distributors, in 1989, and Odlums, Ireland's largest flour producer, in 1989. The 1970s saw tremendous growth in demand for Irish Sugar. The State invested heavily in modernisation programmes. By 1985 borrowing had exceeded £100 million and losses were averaging £8.5 million a year (Annual Report, 1985). During the 1980s, £59 million was invested by the State in the company (Dáil Debates, 6 March, 1990). D Roche TD, on behalf of the government, explained during a Dail debate on The Sugar Bill that the problem for the company was that the State's ambition for it surpassed the capacity to capitalise new ventures (Dail Debates, 26 Feb, 1991).

Since the closure of the Tuam factory in 1986, the fortunes of Irish Sugar were reversed again. Net profits grew from £1.2 million in 1986 to £8 million, £19 million and £22 million in the following three years. In 1989 the Thurles factory was closed and the company bought a share in James Badget and Son, a UK sugar wholesaler (The Sunday Business Post, 21 April, 1991). In 1990 further acquisitions included majority shares in Cresset, a holding company, Sugar Distributors, Grassland Fertilisers and in a UK bakery.

By the time of its privatisation, Irish Sugar was strong and competitive. Although a small producer in European terms, it had become a lean, efficient and growing company capable of vigorous competition. The rationalisation programme of the early 1980s allowed profits to grow from just over £1 million out of £182 million turnover in 1986 to £21.9 million (after interest) out of a £271 million turnover in

1990 (Annual Report, 1990). The company employs over 1,700 people, half the total of ten years ago (Annual Report, 1990).

The company's other activities in fertilisers, animal feeds and agri-chemicals turned over £64 million worth of sales to earn a £6.4 million operating profit (The Sundav Business Post, 21 Aril, 1991). A smaller profit from a larger turnover was earned by the company's food sector. This division is dominated by the company's holding in Odlums and its wholly owned subsidiary, Erin Foods.

In 1989 the government commissioned Price Waterhouse to explore future options for the company. The report favoured privatisation through a share flotation. This occurred two years later. Ireland's first privatisation was presented in a low key fashion unlike many of the British flotations. There was no elaborate advertising campaign, little public debate and not a lot of general interest.

In preparation for the sale the State created Greencore as a holding company. The Sugar Act of 1991 enabled the Minister of Finance to transfer the State's holding in the Irish Sugar Company to Greencore. The Act empowered the minister to "exchange any shares in the company" (Sugar Act, 1991). 50% of these shares were offered for sale in April 1991. The price per share was set at 230p. Employees and beet growers were reserved 6.5 million shares at 184p each, a 20% discount to the full offer price. The employees and growers could also buy more, unreserved shares at the same 184p price. They could not, however, sell any of these shares within two years of the flotation. Instead, their shares would be held for them by a newly created company, Greencore Trustee Ltd. The total share offer included a new rights issue, totalling £22 million, to reduce Greencore's borrowings and to fund expansion of the company. The effect of this issue was to reduce the government's holding to 45%. The Sugar Act 1991 allowed the government to hold on to a 'special' share. This is designed to allow the government to veto any takeover bid by a third party. A further safegaurd against this is the provision that no single shareholder, individual or institutional, apart from the government, can hold more than 15% of the company's shares.

The sale was underwritten by four investment banks including the German *Deutsche Bank Aktiengesellshaft.* NCB acted as stockbrokers to Greencore. Applicant centres were set up throughout the country. Application forms and summary prospectuses appeared in national newspapers. All beet growers and employees were posted share application forms and details of their entitlements. None of these detailed letters and none of the advertisements contained the warning, mandatory in the UK, that share investments carry a risk as the value of shares can go down as well as up.

The offer was oversubscribed. The government raised £63 million and Greencore received £22 million from the flotation. The 230p shares traded for 255p at the end of the first week (Business and Finance, 2 May, 1991).

The sale of Greencore was a successful start to Ireland's privatisation programme. The offer, safely oversubscribed, was received well by institutions and the general public. The £63 million raised for the government had little effect on the national debt but eased the State's PSBR for 1991. As almost £60 million was injected into the company in the 1980s the State has clearly not received a return on its investment.

The State may benefit from the sale in two other ways. The economy now has the prospect of gaining from an efficient, outward looking, privatised firm that is backed by investor's funds and inspired by an ambition to expand further. The State may no longer share directly in the company's fortunes but can share indirectly through dividends and general economic growth. It no longer needs to inject more tax-payer's money into the company.

Secondly, the State may benefit from the precedent set by the first successful medium sized privatisation. If privatisation is seen as a progressive policy (and its case is not complete) the success of Greencore's initial privatisation augurs well for future sales.

Greencore's flotation was an easy one. The transition into a private, ordinary firm was uncontroversial. Its attraction to investors was clear. Its sale was straight forward. No regulatory body, no complex legislation (apart from the sale legislation) and no rewriting of industrial policy were required to facilitate the sale. Future share flotations will be more difficult.

Unexpected difficulties grew for the government's privatisation plans when controversy arose over Irish Sugar's 1990 purchase of Gladebrook. By buying Gladebrook, Irish Sugar gained full control of Sugar Distributors Holdings Ltd (SDH) in which it already had a 51% stake. In September 1991 it emerged that Mr Comerford, the Chief Executive of Irish Sugar, claimed ownership of a Jersey registered company named Talmino which had a 25% stake in Gladebrook. Irish Sugar, with Comerford at its head, paid £9.5 million for SDH. Less than a year before, Gladebrook paid just £1.6 million for the company. Comerford and Irish Sugar's company secretary, Michael Tully may both benefit from Gladebrook's £7 million profit from the deal. Furthermore, Irish Sugar lent Gladebrook £1 million for the original purchase of SDH (Irish Times, 4 March, 1992). None of these details were made available when Greencore was privatised in April, 1991.

In the aftermath of these revelations the government set up a series of investigations. Maurice Curran, a corporate law specialist, was asked to investigate 14 companies involved directly or indirectly (Irish Independent, 13 Sept, 1991). Accountants Arthur Anderson and solicitors, Eugene Collins and Sons and High Court inspectors are also investigating the affair. So, too, are the Central Bank and The Revenue Commissioners and the Department of Finance (Irish Times, 11 Sept, 1991). Messrs Comerford and Tully resigned.

The Greencore affair has several serious consequences for Ireland's privatisation programme:

- While Irish Sugar was State-owned neither the Minister for Agriculture nor the Minister for Finance had full knowledge of the beneficiaries of a major investment by the State sponsored body. No minister or department official adequately queried the large price paid for SDH or the circumstances of the £1 million loan to Gladebrook.
- During the pre-privatisation assessment of Irish Sugar, the board of directors, the officials of the Departments of Agriculture and Finance, and of the IDA, the company's solicitors (A & L Goodbody) and brokers (NCB) all failed to investigate fully the company's recent investments or failed to pass on all relevant

information to the government and to prospective investors.

- The government was unaware of Comerford's connection with Talmino despite his claim that Irish Sugar set up the company for his children as part of an incentive package to encourage him to refuse inducements offered by Goodman's Food Industries (The Sunday Business Post, 8 Sept, 1991). Ironically, Food Industries was later bought by Greencore and Comerford's connection with Talmino forced his resignation.

- The Joint Oireachtas Committee on State Sponsored Bodies has been exposed to be ill-equipped to effectively investigate the affairs of an SSB.

- The apparent, widespread incompetence may seriously damage future share flotations in Ireland. Foreign institutions may hesitate to risk investments in newly privatised Irish companies, fearing that all relevant information has not been exposed. At best the government may be forced to sell State companies at a slightly lower price in order to guarantee a sale. But such a give away may further undermine confidence in a privatisation programme.

THE CASE OF IRISH LIFE

In 1939 the government formed the Industrial and Life Assurance Amalgamation Company (ILAAC) as part of a rescue plan for four troubled Irish insurance companies. The Irish business of five British insurance companies was also taken over by ILAAC. The government injected £1.05 million into the company to own 18%. The British companies held 72%. Irish companies owned the remaining 10% (Business and Finance, 16 Nov, 1989). The 1947 ILAAC Act allowed the government to buy out the British shareholding for £110,000. The act also transferred ILAAC's business to a new company, Irish Assurance Company (later named Irish Life). The company expanded after the war. In 1964 it introduced Ireland's first unit linked policy (Sunday Business Post, 7 July, 1991). It pioneered a variety of managed fund products. In 1972 the company moved towards mutualisation by declaring that 98% of the actuarial surpluses would go to with-profit policyholders and only 2% to the shareholders. Although the government owned 90% of the shares, its share of profits was therefore just 1.8%. This situation was later changed to allow privatisation to take place. No flotation of the company was possible while all that was on offer was a share in 1.8% of profits.

Meanwhile the company continued to grow. It purchased almost 64% of Church and General in 1982, 100% of the American

Inter-State Assurance Company in 1988 and 91% of the Norwegian David Insurance Company in 1990 (Sunday Business Post, 7 July, 1991). Irish Life also has stakes in Insurance Corporation of Ireland and Irish Life Building Society. In 1989 it set up Irish Life Homeloans, a mortgage company (Annual Report, 1989). But in recent years Irish Life's share of the market has fallen due to the entry of new competitors, principally Bank of Ireland subsidiary, Lifetime and AIB's ArkLife. Irish Life's share of the new life policy business fell from 35% in 1988 to about 24% in 1990 (Business and Finance, Nov 29, 1990, p70). The company's position in terms of fund size is unassailable. Nearly half of the total fund market of almost £8 billion is held by Irish Life. Ireland ranks third in the world behind Switzerland and Japan for the highest penetration of life assurance (Evening Standard, 5 June, 1991).

Before deciding how to restructure Irish Life, the government commissioned Ireland's National City Brokers (NCB) and America's Goldman Sachs to report on the options available. The report said that the company could be further restructured, be mutualised, sold through a trade sale or floated to the public (Business and Finance, 16 Nov, 1989, p22). The first two options offered no financial return for the government and a sale of the country's dominant life assurance company to an Irish or foreign company presented many regulatory difficulties. In the end the government chose to reduce its holding in the company from 90% to 34% through a public share offer. The Insurance Act 1990 transferred the shares in Irish Life to a new holding company and enabled the minister to sell "all or many of such shares" (Insurance Act, 1990). The British and Irish courts granted permission for the transfer of the company's business to a newly created Irish Life Plc. Court permission was necessary because of the circumstances of the creation of the original ILAAC.

In July 1991, 139 million shares were offered for sale at 160p each in what was the largest ever share offer on the Irish stock exchange. 39 million shares were offered to the Irish public, 50 million to Irish and British institutions and 50 million to international investors. Employees of Irish Life were reserved prior right to buy £5,000 worth of shares each but at no discount. The company was valued at £482 million, 20 times the 1991 dividends. The expected gross dividend yield was 6.4%, just above the prospective yield from UK markets (Evening Standard, 4 July). The government earned £270 million from the sale, of which £80 million came from foreign investors who now own 17% of the company. Asked why Irish Life did not raise money for itself through a simultaneous flotation of new shares, Chief Executive, David Kingston replied, "we have lots of money now" (Business and Finance, 7 July, 1991, p3).

The costs of the sale were £13 million. NCB and Goldman Sachs were advisors to the government while S G Warburg acted for Irish Life. William Fry and A & L Goodbody were the solicitors to Irish Life and the government, respectively. Just over 30 Irish and international companies underwrote the issue. They earned over £5 million.

The issue was oversubscribed and applications were scaled down, favouring the small investor. On the first day of trading, 22 July, 1991, £30 million worth of shares were exchanged. Share prices rose to 170p but ended the day at 167p, 7p above the offer price (Business and Finance, 25 July, 1991).

The privatisation of Irish Life was the government's second successful flotation of a State-owned enterprise. The sale was orchestrated well and the rewards to the Exchequer were considerable. Since privatisation, Irish Life made an unsuccessful bid to take-over TSB Dublin.

Following the sale, expectations were high that more adventurous privatisations would soon follow. These expectations, however, were dashed later in 1991 when the Greencore and Telecom affairs undermined confidence in the stock market, the government and the privatisation process. However, the scandals did not seem to affect Irish Life's attractiveness as an investment. Its share price and the volume of trading of its shares were unaffected.

THE CASE OF THE GREAT SOUTHERN HOTELS

The Great Southern Hotels group (GSH) was recently sold to Aer Rianta for £10 million (Aer Rianta, Annual Report, 1990). In effect the State shares were transferred from CERT, the State-owned catering school, to the State airport authority. The group owns six hotels, none of them in Dublin. It makes small annual profits. In the past it has even paid small dividends to the government. However, it requires considerable investment to compete with the recent upsurge in hotel construction and renovation.

The sale to Aer Rianta was straight forward and quiet. But the merits of the sale are questionable. None of the arguments in favour of government ownership of enterprises that are discussed in this thesis are applicable to the hotel industry in Ireland. Although Aer Rianta's management is competent and progressive, the retention of GSH within the State sector needs to be justified and rationalised.

From Aer Rianta's point of view, the acquisition of GSH is an important addition to its hotel management and training division. Aer Rianta claimed that it created, "synergy with the existing businesses" and enhanced "core competences" (Aer Rianta, Annual Report, 1990).

THE CASE OF B & I

The British and Irish Steampacket Company Ltd has been State-owned since 1965 when it was purchased for £3.5 million. Since then the exchequer has invested £100 million into its development (Business and Finance, 18 Oct, 1990, p54). Barrett estimates that in today's money more than £230 million has been injected into the firm by the government (Business and Finance, 7 March, 1991, p7). Losses were recorded through the 1980s until 1988 when small profits were earned. Total bank debts have now reached £31 million.

In 1985 the coalition government invited Mr Alex Spain and Zeus Management to revive the ailing company. They failed. Stokes, Kennedy, Crowley were then invited to examine the options available to the company. The accountancy firm reported that apart from closure, the company could be sold to another firm with the government deciding whether to hold onto a special share, or it could be bought by management or it could remain a State-owned enterprise but be subject to another investment project of around £70 million (Business and Finance, 18 Oct, 1990, p54). The government invited management and staff to make an offer for the company. The management and staff offered £5 million (Byrne and Butler, 1991). In the end the government decided, through the B&I Line Act 1991, to sell B&I outright to Irish Continental Group (ICG) for £8.5 million. That is far less than the £230 million of public funds that Dr Barrett believes the government has spent on the company. Furthermore, the government agreed to write off the company's £28 million accumulated debt. It later rescinded an earlier decision to underwrite liabilities resulting from the company's pension scheme and losses resulting from damage to cargo.

It is appropriate that the government should pursue trade sales in its privatisation programme. But a share flotation of a weak company such as B&I would be inappropriate at this time.

V POSSIBLE FUTURE PRIVATISATIONS

THE CASE FOR TELECOM ÉIREANN

The Postage and Telecommunications Act 1983 divided the Ministry of Posts and Telegraphs into two State-owned corporations, An Post and Bord Telecom Éireann (later renamed Telecom Éireann). Telecom Éireann is a "private limited company operating in the public sector" (JOCSSB, 1987, p6). The new company was instructed to keep charges at, "minimum rates consistent with meeting approved financial targets" (JOCSSB, 1987, p5).

Telecom Éireann is Ireland's largest State-owned enterprise. Assets exceed £1.5 billion. Its turnover, productivity and profits are expanding steadily. These are an inspiration for other SSBs. They also target Telecom Eireann as the prize privatisation packet.

Telecom Éireann's 1991 Annual Report reveals a continued growth in turnover and profits. For the year ending 4 April, 1991, the company earned record profits of £94 million from a turnover of £782 million (Annual Report, 1991). (When the company was vested in 1984 it suffered a loss of £66 million.) A dividend of £35 million was paid to the State. The profits represented a 12.1% return on capital, still below the 17%-20% targeted by the then chairman, Michael

Smurfit (Annual Report, 1991). The company decided to absorb the cost of the 10% VAT imposed in the 1991 budget but is unable to absorb the cost of the current 16% VAT rate. Staff levels fell from 18,000 in 1984 to 13,544.

The company continues to expand its new business and joint ventures. It sells a wide range of technological products such as Eircell and Eirpac. Its core activity, telephone rental and use, maintains a great growth potential. The penetration in the Irish market is only 67 lines per 100 households, well below the European average (Annual Report, 1991). Apparent dissatisfaction with the company's services remains. For the period 1988-1990 the Ombudsman received more complaints about Telecom's service than about any other State service (Ombudsman, 1990, p93).

Telecom Éireann is increasingly involved in joint ventures. Long held ventures in its Golden Pages, Cablelink, Eirpage and Minitel products have been supplemented by new ventures with Trinity College Dublin (to form Broadcom Éireann Research Ltd), An Post (Inet Ltd) and New York's NYNEX Corp. (Telecom Phone Watch Ltd) (Annual Report, 1991). The company may participate in the European consortium, Unicom which plans to offer global managed network systems. These are semi-privatisation measures since the State is sharing the risk and the investment costs with private companies (except in the case of Inet Ltd).

There are at least two considerable arguments in favour of the privatisation of Telecom Éireann.

The company's assets are valued at £1,359 million (Annual Report, 1991). Selling just 49% of Telecom Éireann would raise considerable revenue. If floated on the stock exchange, the sale of 49% would be the largest share issue ever in Ireland. The sale would generate a great amount of interest among the general public. To maximise revenue, the government could sell the company in a series of tranches. The initial tranche could be around 30% of the shares and sold through a combination of tender offer and fixed price. Subsequent tranches, a year or so later, could be priced near to the market price of the already traded shares. Throughout, the government could retain a 'special' share to protect against foreign or majority ownership.

A second reason to privatise Telecom Éireann is to allow the company access to private capital and freedom to act commercially. Telecommunications is a technology intensive industry. Research and development of new products are essential to meet the demands of increasingly sophisticated consumers. In the 1991 Annual Report, Mr Smurfit complained that the, "obligation to provide a universal service... represents a potentially heavy burden". The chairman insisted that, "the Company needs the maximum freedom to react to the market and to conduct its business by reference to commercial criteria". By allowing the company access to private funds and by discarding the company's social obligations, Telecom Éireann may expand more aggressively and perform more profitably.

There are several specific arguments against the privatisation of the State's monopoly telecommunications company.

Telecom Eireann is Ireland's most successful State-owned enterprise. It has paid £45 million in dividends to the State since 1990 (Annual Report, 1991). It has undergone an extensive modernisation programme over the last ten years. The company is now technologically advanced and well positioned to expand its range of products. The State and the taxpayer have invested heavily in the company. That investment is beginning to pay rewards. It may be argued, therefore, that it is wrong to sell Telecom Éireann now. Before privatisation can take place the government will probably need to wipe out the company's £1 billion debt. In this case the net proceeds from a sale would be negative and the State would forego future profits from the company.

Secondly, Telecom Éireann is a State monopoly and probably a natural one. For maximum efficiency and for maximum privatisation proceeds, the company will need to maintain its monopoly power after privatisation. A private company would need extensive and expensive regulation. Some form of price formula may be necessary. It is unlikely that a privatised Telecom Éireann, keen to reward its shareholders, would absorb the VAT charges as Telecom Eireann did in 1991. Consumers are likely to suffer. The actions of the near-monopoly British Telecom since its privatisation are not encouraging. Besides, the EC may not permit the company's monopoly powers to remain after privatisation.

Thirdly, a telecommunications system is a vital national resource. Any privatisation may need to safeguard against foreign ownership of the company so that national security is protected.

Finally, full privatisation may be avoided if the company's value-added products and joint ventures are subjected to wider competition and sold independently. Telecom Eireann's monopoly of private telephone equipment and installation could also be relaxed. The core telephone business could be retained within the public sector while newer products could be developed through further joint ventures. In such a case, detailed legislation will be necessary to ensure that the dominant company, Telecom Éireann, grants the privatised ventures free access to its distribution network.

In September 1991, the government commissioned an exploratory report on future options for the company, including privatisation. Soon afterwards, the trade union that represents the majority of Telecom Éireann's 13,544 workers, the Communication Workers' Union (CWU) began a campaign to fight privatisation. They warned that control of the company may fall into foreign hands and that the only beneficiaries from a sale would be 'fat cat' investors (CWU Campaign Posters). If the commissioned report recommends some form of privatisation for the company, its unions are likely to intensify their campaign. Privatisation may be raised to the top of the political agenda.

The 1992 report by the Industrial Policy Review Group did not specify privatisation for Telecom Eireann but called for a pro-competitive approach (Culliton, 1992, p47).

Privatisation of Telecom Éireann may also be hampered by a controversy that resulted in the resignation of the company's chairman. In the Autumn of 1991, it emerged (Sunday Business Post, 22 Sept, 1991; Sunday Tribune, 22 Sept, 1991; Business and Finance, 3 Oct, 1991, p4) that Mr Smurfit controlled a company called Bacchantes Ltd. This company owned 10% of United Property Holdings (UPH), a property investment company managed by National City Brokers (NCB). UPH bought a large Ballsbridge site for £4 million in 1988 from Odlums. The site's ownership was transferred to UPH's subsidiary, Chestvale. UPH sold Chestvale to Delion

Investments, an Irish owned, Cypriot registered firm. Nine months later the Ballsbridge property was sold for £6.4 million to Hoddle Investments who, in turn, sold it to Telecom Éireann for £9.4 million within six months. The large price paid by Telecom Éireann for the property and the link between Mr Smurfit and the original sale to UPH caused his resignation and initiated a series of inquiries. A report by the Department of Industry and Commerce estimated the site's 1990 value at between £6.5 million and £7 million (Sunday Independent, 6 Oct, 1991).

Revelations of this series of purchases occurred during the same period as the Greencore controversy. Both of these events and the political backlash that they precipitated may have damaged the future prospects of privatisation, not least the privatisation of Telecom Éireann. That large State companies such as Irish Sugar and Telecom Eireann can invest heavily in property without thorough ministerial investigations and specific State approval suggests a lack of government control over the nation's assets. Potential buyers of these assets are likely to be suspicious of their structure, management and value. They may fear that other dealings of State companies remain undisclosed.

THE CASE FOR IRISH STEEL

The Irish State took over the Haubowline steelworks in 1947 and created Irish Steel Holdings Ltd. The State ownership of the plant was deemed necessary to aid Ireland's post-war industrialisation and to help ease the severity of the steel business cycle. During the 1960s and the early 1970s, in preparation for EEC membership, an expansion programme was undertaken. This clashed with the over-capacity and the falling prices that had resulted from the policies of the European Coal and Steel Community (ECSC). Irish Steel amassed large debts over the fifteen years that followed. The government injected over £190 million into the company (Business and Finance, 14 March, 1991). In 1984 alone the government injected £89 million (Sweeney, 1990a). An EEC directive of 1985 restricted State investment.

By this time Irish Steel was growing again and its losses were falling. By 1988 a rationalisation plan cut employee numbers to half the level before EEC membership (JOCSSB, 1988a). In 1989 gross profits reached £6.3 million as the steel industry cycle peaked. Large redundancy costs meant that net profits for 1989 were only £2.3 million. This net figure fell to £0.7 million in 1990 as markets slumped. Accumulated losses reached £96 million (Annual Report, 1990). Labour costs continue to be the greatest burden accounting for 71% of total costs. Ferous metals and energy costs were also significant. Consuming around £11 million worth of electricity, Irish Steel is the ESB's second largest consumer (Business and Finance, 18 July, p12). The company remains powerless over its own future. As a small producer it has no control over the price of steel. It must rely on international trends in the steel market. The outlook is uncertain with the precarious conditions of the German, American and British economies. The future of the ownership of Irish Steel is also far from clear.

Despite McDowell's 1987 assertion that "no one in his right mind would buy Irish Steel", the government has been interested in selling off Irish Steel for the past few years. There have been a number of interested buyers. The most interested and most persistent offer came from the German steelmaker, Willy Korf. He offered to buy Irish Steel for only £1 (one pound). He promised to invest heavily in Haubowline and in a pig iron plant in Bavaria, southern Germany (Business and Finance, 16 Nov, 1989, p3). The total investment was expected to reach £120 million. The deal was delayed as the government investigated it and its proposer. Korf appeared intent on the purchase and the deal was not unreasonable given the expected downturn in the steel business cycle. But the government feared a political row over the £1 sale price especially if the planned investments failed to occur. The deal was repeatedly delayed until, tragically, Korf was killed in a plane crash in 1990.

There have been other interested buyers. British Steel, already a major seller in Ireland, expressed interest but produced no financial proposal. North Star of Minnesota and ISPA of India were also keen (Business and Finance, 15 Nov, 1990; Business and Finance, 18 July, 1991). All three companies had records of turning around loss making plants. All insisted on a rationalisation plan, that included job losses, before they take over. By the summer of 1991 the government remained undecided. The Minister for Industry and Commerce appeared to favour a different proposal. That came from the company itself. The management argued that they had already brought the firm through difficult times and to a profit making position. They proposed a continued restructuring, involving further redundancies. The government may go ahead with this management plan. It is an interim measure that, at least, allows the government more time to find the right buyer. In the meantime the company can continue to rationalise and to expand profits.

The privatisation of Irish Steel is likely at some stage, despite the management plan. Non-European firms are keen to enter the Internal Market. The government is keen to raise revenue from a sale. A share flotation cannot be ruled out. The company already has share capital of £125 million. All but £10 of this is held by the Minister of Finance on behalf of the nation. The remaining ten £1 shares are held by each of the ten directors of the company (JOCSSB, 1988a). The structure for a sale is already in place.

No sale is likely to raise the £190 million that the government has injected into the company. Perhaps it is best for the government to maintain ownership of the company now that it can earn a return on its investment. But the company's present profitability is highly tenuous given the volatility of the steel industry. Besides, any sale of a heavily indebted company that has only recently become profitable cannot significantly improve Ireland's public finances.

THE CASE FOR BORD NA MÓNA

The Irish Peat Board, Bord na Móna (BNM), was set up in 1946. Its main activity is the harvesting of milled peat from Ireland's expansive midland bogs. It is also involved in the production of moss peat and agri-chemicals. Scott and Convery (1990) assert that BNM was created by the State to exploit the economies of scale in peat extraction and to finance the development of capital equipment. In its early days the company was run by the Department of Social Welfare. This reflected its important role as employer in the economically depressed areas in which it operates. This role, however, did not help its efficiency. By 1991 it had consumed massive State investment and amassed accumulated losses of almost £200 million.

The rationalisation plan for the mid-1980s included 1,700 redundancies to reduce staff to 2,400. but losses grew to £17 million in 1985/1986. These fell to £3.4 million by 1987/1988 but jumped to a massive £91 million in 1988/1989 (Annual Report, 1990). This huge loss included the £50 million cost of an investment project in Co. Galway and the write down of assets, principally the briquette factory in Co.Tipperary. Another £30 million is attributable to redundancy costs. The underlying loss, therefore, was about £11 million. In 1989/1990 the company made a small profit of £2.5 million. Underlying efficiency has improved. Eddie O'Connor, the Chief Executive, reported that, "In 1987 we produced 4.4 million tonnes of milled peat at a cost of £38.4 million. In 1989 we produced 5.5 tonnes at a cost of £28 million." (Business and Finance, 8 Feb, 1990, p17)

The company is ambitious for the future. It has already bought a horticultural peat manufacturer in France and plans further acquisitions around Europe (Business and Finance, 8 Feb, 1990, p8). It hopes to increase production significantly through a new method of peat manufacturing. Its R&D work has produced two successful innovations designed for environmentally conscious markets. It has benefited from the government's decision to ban bituminous coal use in Dublin. But another R&D project in Britain may undermine BNM's moss peat business. Coco peat, made from disused coconut shells, is being tested (<u>Business and Finance</u>, 6 Sept, 1990, p45). If horticulturalists opt for it, BNM will suffer a fall in sales. There is already a growing reluctance to use moss peat because its production is seen as environmentally destructive.

Although now trading profitably, BNM has sought another £100 million capital injection from the State. Last year O'Connor said that, "if the government wants to see the company grow it should inject some equity" (<u>Business and Finance</u>, 8 Feb, 1990, p18). The government has refused this aid. The company received a grant of just £500,000 for 1991 (Stationery Office, 1991b). The Minister for Energy, though, has asked the ESB, who buys more than half of BNM's milled peat output, to increase its intake. (<u>Business and Finance</u>, 29 Nov, 1990, p34).

In 1988 a quasi form of privatisation was introduced. Companies of four or five former employees were formed. These sell milled peat to BNM who leases to them the land and the machinery. Full privatisation is a distant prospect. The massive indebtedness of BNM makes it very unattractive for a share flotation. The company must continue to expand, increase profits and reduce its debts. It could explore joint ventures at home and abroad. The company is examining this and other options such as an MBO and an EBO. The company may be bought eventually by staff or management or be taken over by a third party. Any development will be subject to assurances that employee numbers are not radically altered. BNM remains a hugely important employer in the Midlands and the West where unemployment is high. Its employees, however, are the second worst paid among all the commercial State sponsored bodies (Sweeney, 1990a). It is its role as an employer that makes the privatisation of BNM a low priority in the government's privatisation programme.

THE CASE FOR AER LINGUS

The market failure reasons for initial State involvement in the airline industry in Ireland were, according to Convery, lack of local expertise, enterprise and capital (Convery, 1987). The air transport industry is characterised by a definitive business cycle. In 1991 it reached the trough of the cycle. It had peaked just over a year before.

The Irish air transport industry suffered a series of setbacks that sharply reduced already tight margins. The deregulation of the European and American airline industries brought reduced fares and increased global competition. The busy Dublin-London route was no exception. Fares fell and the number of airlines servicing the route increased. Then, in 1990, the UK market collapsed due to recession. The effect of this on the construction and tourist industries greatly reduced those sectors' contribution to the air transport industry. Construction workers and tourists have been constant and frequent users of the Dublin-London route and of other routes from British regional to Irish regional airports. The Gulf War also reduced the number of passengers and increased fuel costs. These factors forced British Airways and PanAm out of servicing Ireland. The very low fares offered little chance of good profits.

Aer Lingus has suffered from all of these developments. Having increased profits in the late 1980s despite increased competition, the State airline is now in a difficult position. This year's fuel bill is set to rise from £40 million to £60 million a year (<u>Business and Finance</u>, 10 Nov, 1990, p10). Its holidays company, Air Lingus Holidays, has collapsed. Losses of £4.3 million were recorded (Annual Report, 1990). Its demise may be partly the result of fraudulent deals from within Aer Lingus and the subsidiary. Group returns fell to a £10 million loss for 1990/1991. The main cause of this was the £40 million loss in the air transport sector. This sector made a cumulative loss of £100 million in the last three years (<u>Irish Times</u>, 26 March, 1992). All of this is happening mid-way through Aer Lingus's £400 million fleet replacement programme. The company is unable to service the £1 billion programme from its operating profits. The group's gross indebtedness is almost £500 million (White, 1991). As a public company it is not expecting much capital injections from its only shareholder, the government. The prospect and the need for some private investment, perhaps in the form of privatisation, is now clear. The company is expected to issue £25 million worth of bonds on the Dublin gilt market (White, 1991). A condition of the issue is that a majority of the company's equity will remain in State hands for the lifetime of the bonds. But, presumably, by redeeming the bonds early, the government would be free to sell the company complete.

Aer Lingus has already sold its American Hotels holding for $100 million (Annual Report, 1990) and part of its shareholding in Guinness Peat Aviation (GPA) for $68 million (Annual Report, 1991). Privatisation options include further sales of its hotel assets and GPA holding (valued at £172 million [Business and Finance, 22 Nov, 1990, p5]), its share in Irish Helicopters and its successful, wholly owned subsidiaries PARC, Airmotive and TEAM. All of these are likely to attract eager buyers and could cover the cost of the current stage of the company's jet replacement programme. In that case there will be no return for the State. On the option of selling the whole of Aer Lingus, Chief Executive Cathal Mullan asks why "sell an appreciating asset?" (Business and Finance, 22 Nov, 1990, p12). It is the company's ancilliary services, principally its aircraft ground handling and maintenance services, which are both easiest to sell and principal contributors to the company's profits. Without them the company would be weak and a large loss maker.

The European airline industry, like so many others, is consolidating. Lufthansa and Air France have bought many smaller companies. Aer Lingus is a relatively small company. The Irish government should find little difficulty in attracting a buyer. But a sale to a foreign airliner may not arouse popular public support.

Another option, short of complete divestiture, is to privatise by way of a joint venture with another airline company. Such a partnership could share the cost and rewards of new capital investment. Aer Lingus can maintain its own corporate identity and the government can retain a 100% ownership while the costs of investments can be shared. Profits and losses must be shared too. A joint venture has already begun between Aer Lingus's subsidiary, Airmotive and United Technologies to form an engine over-hauling firm, PWA International. In 1988 Aer Lingus was an unsuccessful bidder for a 25% stake in British Midland, losing out to a Scandinavian airline (Byrne, 1992).

The privatisation of the Irish State airline company, in any form, will lead to ideological arguments. The affinity to Aer Lingus as Ireland's air carrier that is held by the Irish people is acute. This affinity offers both hope for a very successful public share offer (£36 million worth of shares already exist, all held by the Minister of Finance [JOCSSB, 1989]) and fear of public disquiet that the company be taken out of State hands at all. Any form of privatisation of Aer Lingus will be political and emotive. As Minister for Finance, Albert Reynolds was, "reluctant to sell a majority stake in the airline" (Sunday Business Post, 7 July, 1991). Practically, privatisation can succeed. A share flotation of the whole company remains an option. There would likely be keen public interest in purchasing shares. Much revenue can be raised. The company could be sold in a series of tranches in order to maximise profits. Second and subsequent tranches could be sold using the 'market price less discount' formula that guarantees a fair price for investors and a successful sale in general. This method also eliminates the costly underwriting of the second and subsequent sales. However, the merits of any divestiture will need to be firmly established.

The break up of the company and the sale of its subsidiaries would quickly and easily raise money for the government and the company. Its subsidiaries would find ready buyers. But a fragmented Aer Lingus would be a shattered company. What would be left, a loss making air passenger service, would be a continued burden on the State whose net gain would be negative. Aer lingus relies heavily on its ancillary activities to maintain quality, reputation and profits. Any break up of the company would be short sighted. However, its corporate identity would not be affected by the sale of its valuable stakes in GPA and in the hotel industry.

All privatisation options bring fears of redundancies. The 7,000, highly unionised Aer Lingus workers will probably fight privatisation. Their average earnings are among the highest in the public sector (Sweeney, 1990a). Apart from employee share bonus schemes, any privatisation of Aer Lingus will need to accomodate the hopes of its employees. They and their unions have shown in TEAM (The Experts in Aircraft Maintenance) that they are willing to change working practices for the good of the company.

The JOCSSB in its second study of Aer Lingus (1989) feared that privatisation may result in foreign ownership of the company and a loss of dividend to the Irish government. It also feared a fall of employment and a deterioration of services that may result in damage to Ireland's attractiveness as an industrial base.

THE CASE FOR AER RIANTA

Aer Rianta owns and manages Ireland's three largest airports, Dublin, Shannon and Cork. This part of its business earned half of the company's record £28.4 million profit for the year 1990 (Annual Report, 1990). Almost eight million passengers and almost a quarter of a million aircraft passed through its airports. Passenger numbers in Dublin Airport have doubled since 1985. The other half of its profits were made from Aer Rianta's highly successful and much publicised duty free outlets and associated commercial activities. Despite profits falling to £22 million in 1991, the company managed to increase its dividend to the government to £18 million.

Despite its monopoly position, the State airport authority has shown itself to be dynamic and progressive. Four new joint ventures with Soviet partners were announced in 1990. There are also planned developments in Bahrain, China, Malta and Japan (Annual Report, 1990).

Like the State airline, Aer Rianta is at a crossroads. It has suffered a fall in business due to the Gulf War and British and American recessions. Great uncertainty surrounds the long-term future of its intra EC duty free operations. McGahern (1991) specifies the uncertain effects of the completed channel tunnel and the continued regulatory obstacles of hubbing as key concerns of the airline industry. As Aer Rianta expands its ventures in airport management and duty free operations abroad, there can be little doubt that this highly innovative State-owned enterprise will successfully adopt to changing circumstances. However, there remains too many uncertainties in the airline industry in general and in Aer Rianta's operations in particular, to allow any privatisation for the immediate future.

The question of the compulsory Shannon stop-over remains unresolved. Shannon has been a highly successful venture. It has not only acted as an historically vital link with US transfers but is a very successful centre for aircraft maintenance and aircrew training. The airport, together with the State-owned, Shannon Free Airport Development Company (SFADCo), has promoted a huge growth in tourism and industrialisation in the West and Mid-West regions. Its contribution to the regional and national economy remains huge. Its partnership with Aeroflot has developed and widened and continues to offer exciting prospects.

The compulsory stop-over for planes heading to, or coming from America, has caused a loss in business for Aer Rianta and a loss in revenue for Ireland as a whole. Several US carriers, including PanAm and United America, say they will not service Dublin as long as the compulsory stop-over remains. The needless landing, just over 150 miles from Dublin, not only adds hours to the flight time but adds costs of fuel, crew time and increased depreciation of aircraft. The stop-over, though, is important for Aer Rianta. Shannon airport contributed 45% of Aer Rianta's turnover in 1988 (but only 15% of its profits) [Business and Finance, 1 Feb, 1990, p110].

Shannon has another attraction for airlines. The American Immigration Pre-Inspection operation in the airport is attractive to UK regional airports as it saves the time lost in transferring US bound passengers via the busy Heathrow or Gatwick connections and the time lost at busy American Immigration controls.(Business and Finance, 10 Jan, 1991, Special Review, p34)

Dublin, too, is hoping to develop a hub type operation. Dublin can become the connection for airlines flying from regional European airports, principally British and French, travelling to the Far East. Dublin is attractive as it does not have the high landing costs and long delays associated with the large London and Paris airports.

Aer Rianta has expanded its operation by acquiring the Great

Southern Hotel Group. This purchase complements Aer Rianta's catering school in Shannon and its hotel management in Russia.

Aer Rianta, like Aer Lingus, is undertaking a thorough modernisation programme. With some EC funding, Aer Rianta is developing and extending its three airports. Any privatisation of Aer Rianta should wait until this investment project is complete. The company will then be a more diverse, adaptable enterprise. It is worth more whole than as a basket of parts. Selling off its subsidiaries could destroy its corporate image.

This dissertation has repeatedly asserted that privatisation alone does not guarantee any improvements in efficiency or productivity. Deregulation and the removal of anti-competitive practices are better policies to achieve the desired goals. Legislation should be introduced to enable competition among the three airports. It may be possible to maintain Aer Rianta's umbrella role over the airports but to sell them independently. This, though, would be an elaborate and expensive flotation. It may yield bureaucratic problems. The dynamism of Aer Rianta may be jeopardised. Alternatively, the government could consider the sale of one of the three airports which could then compete against the other two. Aer Rianta's ancillary activities need not be affected.

If a case for the privatisation or radical deregulation of Aer Rianta is empirically established, no move should take place until the company's modernisation programme is complete and the Shannon stop-over controversy is settled. However, that settlement should not be based upon the deregulatory plans. The stop-over should not be ended merely to ensure a successful sale. It must be settled separately. The government must constantly monitor the likely effects of ending the stop-over on the Dublin, Cork and Shannon areas. Politicians representing the Shannon area and at least one independent study (reported in Business and Finance, 11 Feb, 1990) project disastrous results from an ending of the stop-over. The devastating effects on industry, employment and tourism in the region, as well as effects on Aer Rianta, Aer Lingus and others, must all be considered by the government. If the ending of the stop-over is deemed to be a vital prelude to any deregulation package, these financial and social costs must be included in the overall cost estimates.

THE CASE FOR THE ACC AND THE ICC

The Agricultural Credit Corporation Ltd. (ACC) is one of Ireland's oldest State-owned enterprises and was the first bank to be established by the Free State (Annual report, 1990). It was established in 1927 to supply medium and long-term loans and general banking facilities to farmers and co-ops. In 1977 the company's role was extended to include all agricultural industries and the fishing industry (CEEP, 1988). The 1988 ACC Act allows the company to widen its service to non-agricultural sectors. The company has developed its four key business areas: agri-business, corporate banking, small business and personal banking.

The ACC made a profit of £5.2 million in 1990 having made a large loss of £14.9 million as recently as 1987 (Annual Report, 1990). 1991 was a more difficult year with the company suffering from the effects on agriculture of the British recession, the collapse of trade with Iraq, the demise of Goodman International and the uncertainties of the CAP reform. Many of these difficulties remain in 1992.

The Industrial Credit Company Ltd. (ICC), established in 1933, is charged with the promotion of small to medium sized firms. The company has a number of subsidiaries involved in corporate finance, fund management, international finance and merger and take-over activities.

In 1991 the ICC made after-tax profits of £5.9 million, down slightly from the previous year (Irish Independent, 4 March, 1992). The company was one of a few SOEs that paid a dividend to the State. In 1989 and 1990 the dividend paid was £1.43 million (Annual Report, 1990).

The privatisation of the ACC and the ICC is likely in the medium term. The government has stated its intention to sell the two companies through a private placing or through a flotation when there is an improvement in the banking and agriculture sectors (Cooper, 1991). As Minister for Finance, Albert Reynolds has declared that "there is no reason for the State to be involved in the financial sector" (Cooper, 1991).

If the privatisation of the ACC and the ICC is to proceed, its timing is crucial. The current depressed State of the economy and of share prices, and the damage caused by the prolonged bank strike make the sale of either financial company unlikely for now. To protect the government's privatisation programme (if one still exists) the next privatisation (of ACC, ICC or any other enterprise) must be well judged, well prepared and well received by investors. The key element of any sale is confidence. At the moment little confidence is apparent. On the other hand, a successful sale at this time may be the necessary impetus to restoring some confidence. To sell now may be a bold initiative. But it is unlikely to maximise revenue.

As the government awaits improvements in the economy and in investor confidence, the merging of the ACC and the ICC could be considered as an alternative to their privatisation. The combination of two financial companies (suggested by Cooper as far back as 1988) would create a financial institution of considerable means and influence. The economies made by such a merger may greatly increase the combined worth of the two companies. The government could later decide whether to privatise or to retain the merged company within the State sector and benefit from its increased potential.

THE CASE FOR THE ESB

The turnover of the ESB was the largest of any semi-State company in 1990 (Business and Finance, 31 Jan, 1991). The company's performance improved further in 1991. For the six months to June 1991 profits rose by 22% to £9.4 million.

The ESB is a vertically integrated utility providing the generation, transmission and distribution of electricity. It was set up in 1927 after the early success of the Free State's investment in the Shannon Hydroelectric scheme on Lough Derg. A need arose for a coordinated, regulated and responsible body to control the generation and distribution of electricity in Ireland. Apart from a reported interest from the Brussel's based European-American consortium, the private sector were unwilling to finance the huge investment required (Manning and McDowell, 1984, p57).

Industry Minister, McGilligan, the primary force behind the electricity drive in Ireland, decided that a public corporation structure would be best suited to the tasks of innovation and commercialisation and yet remain under the general control of the State. He opposed a government Department of Electricity because of the, "inefficiency inherent in the system of State service because civil servants are allowed the privilege of permanent entrenchment irrespective of the quality of the service rendered" (Manning and McDowell, 1984, p58). An electricity supply board, on the other hand, could maintain the autonomy and flexibility necessary for such a technologically intensive enterprise but remain under the financial and general control of the government. (Sir John Keane, a Senator at that time, opposed the bill to set up the ESB warning against the, "poisonous virus of nationalisation".) The pricing mechanism was unspecified by the Electricity (Supply) Act 1927 except that charges should, "be fixed at such rates... that revenue... will be sufficient and only sufficient to pay all (expenses)" (Section 21.2).

Since its inception, the government has invested heavily in the ESB's electrification of urban and rural Ireland. The State enterprise played a vital role in the overall industrialisation of the country. The company has expanded its effective capacity by over 70% since 1980 as a result of a capital investment programme costing several billion pounds (Scott, 1991, p1). It also played key roles in the development of BNM and in the industrial potential of the nation's poorer, remote regions. Liberalisation of electricity generation and distribution will need to be accompanied by strict regulation so that the ESB's economic and industrial roles are not sacrificed. Any privatisation of BNM, Bord Gáis and the ESB will depend on such regulation.

In 1986 the JOCSSB studied the ESB. Employing over 12,000 people and supplying 1.2 million customers, the ESB is the country's largest home based industrial operation (JOCSSB, 1986c, pi). The committee said that the board's accumulated losses should be phased out and that any further borrowing should be from domestic sources so as to eliminate the risk of currency fluctuations. Employee numbers should be cut by around 2,000. Prices, the committee said, should be, "tilted in favour of industrial consumers" (JOCSSB, 1986c, pvi). The board should move away from ancilliary businesses such as its retail outlets. The 1992 report of the Industrial Policy Review Group said that the ESB's financing of BNM should be ended or, at least, the price of peat greatly reduced

(Culliton, 1991, p47).

The privatisation of the British electricity supply industry (ESI) was hugely complex. Twelve regional electricity distribution companies and two giant generation companies were sold in a series of flotations. The full effect of their privatisation has yet to be determined. From the ESB's point of view, the privatisation of the UK's ESI and the EC's interest in a community-wide electricity network, raised many questions about the of future of the ESB. A report by Business and Finance in January 1991 examined the possible privatisation options for the ESB (Business and Finance, 17 Jan, 1991). A share flotation of the whole company is unlikely. Ireland's domestic investment markets are ill-equipped to finance or even underwrite such a sale. Besides, the company's £1.5 billion debt makes its ownersip far from attractive. Other difficulties associated with the ESB (highlighted by the JOCSSB, 1986, p16) include the company's dated power stations, high reliance on inefficient peat, small domestic market and low *per capita* consumption.

The company must also maintain a high reserve of electricity because it is not connected with another electricity utility. The privatisation of Britian's ESI may open opportunities for the ESB to negotiate an interconnection with Britain's PowerGen or National Power. Such interconnection would be in line with EC strategy.

Although the Irish government will not copy the UK's geographical break up, the division of the ESB into generation and distribution remains a possibility. For a start the government could retain the role of electricity generation thereby maintaining the direct government control of this key resource. The distribution of electric power to the consumer could be privatised by either the sale of the ESB's distribution plants or the liberalisation of distribution licences. Private companies from Ireland or abroad could tender for distribution contracts.

A simple form of competition would be competitive bidding for the contract itself. The contract would be renewable only if an acceptable quality of service is produced and a new, competitive bid is proffered. This approach could be introduced in pilot areas such as Limerick or Cork, areas in which comparable statistics could be formulated. This will deregulate the industry but its effects on efficiency are uncertain.

Alternatively, two or more companies could compete periodically with the ESB for business throughout the country. Large businesses, hospitals, perhaps towns could choose the company offering the best terms. Legislation would be necessary to permit the licensed, private companies to use the ESB's existing distribution network. Price, quality and service regulation would also be required. The ESB recognises the opportunities for private companies to build and operate generating stations and to sell the electricity on to the utility grid (Annual Report, 1990).

These private companies could compete with the ESB's own generation in the sale of electricity to the distribution company or companies. A competitive, though regulated market could be developed.

The ESB's retail network which sells many durable, consumer goods, could be privatised. Established sellers of 'white consumer durables' may be interested in buying some or all of the ESB's large number of retail outlets. The full effects of such sales must first be assessed.

The ESB's current corporate plan, 'Connecting with the Future', provides the strategy for the 1990s. The company aims to invest in new capital in order to meet projected demand. Demand-side measures will attempt to contain growth below 3% pa.. For 1990 growth was 5.4%, up from 5.2% for 1989 but for 30 years growth averaged 8% to 10% p.a.. Growth of 6% or more poses "almost insurmountable problems" (Annual Report, 1990). These problems include the need to increase borrowings in order to finance the construction of new facilities required to meet the demand. Already the company's outstanding debt has reached £1,050 million, 1.4

times its income. This debt will grow if managed demand policies are unsuccessful in controlling rapid growth in demand. The company is also keen to respond positively to EC directives on environment protection.

The ESB foresees a continued high use of natural gas and low sulphur oil. The company will, "continue to support national policy in relation to peat", depite the "considerable cost burden" (ESB, 1990, p170). Investment in new peat fired generation plants is not planned because of the finite life of the bogs. Investment in gas fired plants will depend on guarantees of future supplies. The company welcomes the idea of both interconnection with UK electricity supplies and a pipeline to North Sea and European gas.

The ESB is already benefiting from the liberalisation of the Euopean electricity supply industry. It is involved in a joint venture with Britain's East Midland Electricity and another private company to operate the Corby power plant. It has already won maintenance contracts in Britain worth over £1 million a year (Business and Finance, 17 Jan, 1991, p14). Further consultancy and maintenance opportunities may arise as the European Community develops a transnational power network. As international boundaries fade within the electricity industry, governments will come under increased pressure to withdraw from State control of electricity generation and distribution. Although the privatisation of the ESB is not imminent, the State's relationship with the ESB is sure to change.

THE CASE FOR BORD GÁIS ÉIREANN

The Irish Gas Bord (BGE) was set up in 1976 to manage and distribute natural gas recently discovered near Kinsale. The company has developed a transmission network for the eastern, southern and south western regions of Ireland. In 1990 gas created 15% of the energy required in the country. To date this represents a saving on our imported fuel bill of around £2 billion (Dáil Debates, 13 June, 1991). The company hopes to widen its market by continual extension of its Irish network and by development of an interconnector with Britain (Annual Report, 1990).

BGE reluctantly took over Dublin Gas in 1987. The chief executive at that time, Mr. Dineen, revealed that "we took it over because the government wanted us to" (Business and Finance, 15 Feb, 1987). McDowell (1987) says that this vertical integration, although administratively convenient, has facilitated cross subsidisation and inefficiency. The company also plays a key role in controlling the energy costs for the ESB and NET (Scott and Convery, 1990). It sells gas to both companies at a preferential rate.

BGE has been profitable since the beginning of the 1980s. In 1990 profits were £43 million which helped to finance the large capital expenditure programme (Annual Report, 1990). Between 1978 and 1991, Bord Gáis paid a total dividend of £260 million to the State (Dáil Debates, 13 June, 1991). The company has marketed aggressively to increase its sales. The 1990 ban on the sale or distribution of bituminous fuels has indirectly highlighted gas as the clean, environmentally friendly energy source.

The JOCSSB examined BGE in 1986. Among the committee's recommendations were that the company's pricing policy allow flexibility in its charges to industrial firms. However, the committee also called for the publication of the levels of subsidisation of the gas bought by the ESB and NET (JOCSSB, 1986b, p14). That same request was made by a 1992 report of the Industrial Policy Review Group. That report also promoted the building of an interconnector with Britain's gas network (Culliton, 1992, p48). Plans for the interconnector are at an advanced stage. The project will cost around £240 million (Dáil Debates, 13 Jan, 1991).

BGE is a possible candidate for privatisation in the medium term. Privatisation is not likely to occur in the next few years because of the continual cost of its capital development programme and because of the uncertainties of the energy market. If the government favours privatisation, it should be delayed until the company has completed this development. Although a flotation of BGE could raise the highest revenue of any Irish sale, its merits and demerits must be accurately determined.

THE CASE FOR CÓRAS IOMPAIR ÉIREANN

CIE was formed in 1946 when a number of railway companies merged. These companies had, under the direction of the 1932 Transport Act, compulsorily bought Ireland's private bus firms. The position of the railway companies had been under threat from the legion of private, versatile bus companies that operated throughout the country. By 1946 the bus and railway sectors were partners in the centralised CIE. For decades that followed CIE received massive State subsidy. Despite this and despite the amalgamation of the bus and rail sectors, the rail transport business in Ireland has declined steadily.

CIE as a whole is massively loss making. Its accumulated debt has reached £207 million (Annual Report, 1990). In 1990 the company's trading surplus was just 1.2 million after a State grant of £110 million. This level of subvention, the company claims, "reflects the nature of our public transport services which are on a scale that cannot be self financing" (Annual Report, 1990).

Although the rail network has shrunk, the bus transportation sector has boomed. The Transport (Re-organisation of CIE) Act, 1986 changed CIE into a holding company consisting of

Dublin Bus, Bus Éireann and Irish Rail. Each sector operates serparately and independently.

Regulation continues to be a strong feature of the transport industry in Ireland. Irish Rail is a monopoly company, heavily subsidised by the State. The £5.8 million profit made by Irish Rail in 1990 hides a £88 million government grant. The company enjoys complete protection from direct competition. Despite this, the company's services are poor, the number of rail routes is historically low and its capital stock is aged and consumer unfriendly.

Competition for Irish Rail is indirect but effective. Bus Eireann and a large set of bus operators compete against each other and against Irish Rail. State grants to Bus Eireann amounted to just £5 million in 1990. But any level of grant is too much. Unfair competition clearly exists when one firm receives preferntial treatment over another. The preferential treatment afforded to Bus Éireann consists of the State grant and the 1932 Transport Act which prohibits the operation of a scheduled bus service without a licence. White and Barrett both claim (<u>Business and Finance</u>, 15 Feb, 1990) that the original rationale of such protection was to protect the railways from competition by the bus operators. This protection has failed to end the rail's decline.

As the granting of licences is increasingly liberalised, Bus Éireann has faced fierce competition from new, private operators. The State company, however, has reorganised and rescheduled. It has successfully regained market share. Private bus companies complain that Bus Éireann's competitive push has been financed by both State aid and cross-subsidisation. They claim (Business and Finance, 15 Feb, 1990) that Bus Éireann has introduced below cost charges for routes which they , the private operators, had developed. With the aid of taxpayers' money, Bus Eireann is crowding out private, scheduled routes.

Complete deregulation of the provincial bus licencing laws may improve efficiency. Bus Éireann could be subject to open competition and be forbidden to cross subsidise. The State company should be compelled to reveal the costs of each route. These can be compared to prices charged. Where uneconomic routes are identified tenders may be sought from private operators for a 'least subsidy' type of contract. Private contracts have been a feature of the school bus system for a long time. The scheme is thought to be cost efficient but private operators complain that Bus Éireann have an unfair advantage since its holding company, CIE, is the administrator of the scheme (Barrett, 1990).

THE CASE FOR AN POST

The Postage and Telecommunications Services Act 1983 separated the postage and telecommunications duties that were hitherto carried out by a government department. The newly formed An Post kept a monopoly over the carriage of postal packets, principally letters and cards. The 1983 Act requires An Post to meet the industrial, commercial, social and household needs of the State (Dáil Debates, 7 Feb, 1991). An Post is also obliged to break even.

An Post faces fierce competition in other areas of communications that are growing steadily. These include the delivery of parcels, telegrams, documents and newspapers as well as facsimile and electronic data interchange. There is little that cannot be done by private, competitive agencies. Indeed, stealthy privatisation has occurred as more and more private firms rival An Post's courier activities. The JOCSSB describes the status of these private couriers as, "legally ambiguous" (JOCSSB, 1988b, p5). There is a growing need for new legislation to clarify and widen the degree of legal competition to the services of An Post.

An Post is in a very serious financial position. In its present State, the company is not a likely contender for privatisation. Since its inception in 1984 company profits were transformed from a £5 million loss in 1984 to a £1.6

million profit in 1988. But losses have returned and reached £3.1 million in 1991 (Irish Times, 30 April, 1992). The company's current management viability plan is part of an industrial dispute with workers. The three year programme replaces the failed 'Partnership for Progress' agreement between management and unions whose primary aim was to cut working hours. The replacement plan was described by Business and Finance as, "probably the most radical shakeout ever proposed for a semi-State company" (Business and Finance, 14 Feb, 1991, p40). The far-reaching plan is designed to drastically cut wage costs which represent 80% of total costs in the Dublin area, and to shed the burden of remote, underused sub-offices. This strategy hopes to cut annual costs by £24 million by 1995. The proposals include cutting the 7,500 workforce by 1,000 through natural wastage and voluntary redundancies and the closure of 500 to 600 sub-offices (which in total account for about 2% of business) and delivery service reduced to once a day (Business and Finance, 7 Feb, 1991, p16). It is also proposed to increase borrowing in order to finance a major investment programme in new technology aimed at cutting man hours.

The radical plan is meeting much resistance from staff whose jobs and overtime hours are at risk and from the public concerned about the effect that the sub-offices may have on rural community life. The need for a fundamental restructuring of An Post along the lines of the new Viability Plan is acute. It is impossible for the government to consider the privatisation of An Post until the company is restored to a profitable position. Many challenges lie ahead. The Viability Plan is aimed at cutting costs by cutting wage bills and by shedding burdensome, inefficient sub-offices.

The company is also faced with a crucial marketing battle,. Ironically, this is the result of the deregulation of Ireland's telecommunications industry in the early 1980s. One major competitor is its half-sister, Telecom Éireann, whose modern communications systems and computer data facilities rival An Post's core business. Another semi-State company, Irish Rail, offers a rival Fast Track parcel delivery service. Other competitors are the courier services offered by companies such as Excel/Pony Express and TNT/Skypack. In response, An Post is developing its marketing strategy in these sectors. Its Special Delivery Services targets the parcel and business sectors. An Post's banking services are well developed and marketed. The high interest, tax-free incentives generate a large level of investment. The sale of the administration of these financial products and of An Post's banking system in general may also be considered by the government. Their effects on competition and efficiency are uncertain.

An Post owns an 80% holding of the National Lottery Company (the remaining 20% is held by the Minister of Finance). This company is highly profitable but is criticised for its high level of costs. An Post could sell part of its stake in the subsidiary. Private control of the country's only lottery company would attract much political and public opposition. The company tenders through competitive bidding the contracts for its on-line games facilities. In a 1990 report, the JOCSSB criticised this open competition and called for the work to be done by an Irish firm. Such criticism and such a call is wholly contrary to the thrust of this dissertation.

Privatisation of An Post as a whole remains a distant option. If the merits of its privatisation are deemed attractive, much work must first be done on the further restructuring of the company and on a radical improvement in productivity. The company's ancillary activities may be opened to competition through contracting and the liberalisation of legislation. This deregulation will need to be accompanied by a thorough restructuring of the company's core activity. Much depends on the success of the current viability plan.

NOTE: The conclusion to this chapter's examination of Ireland's privatisation options forms part of Chapter Six which is a general conclusion to this thesis.

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CHAPTER SIX

CONCLUSION

CONCLUSION

This dissertation examined the theory and practice of privatisation. The study began with a debate on themerits and demerits of the use of privatisation as an economic and political tool. Privatisation is any attempt to replace in whole or in part, the production of goods or services by the State with private production. This may involve the complete withdrawal of government subvention, the opening up of competition, the expansion of joint ventures, the deregulation of entry and procedures or the sale of part or all of a public company.

The hypothesis introduced at the beginning of this study has been found to be true. Chapter One showed that although privatisation may contribute towards increased efficiency, wider competition and a short-term reduction in the PSBR, it may also result in an inequitable redistribution of wealth, an increase in prices and, in some cases, a deterioration in the quality of services. Neither the case for nor the case against privatisation triumphs. Privatisation alone is not a sufficient stimulus for improved efficiency. Nor has the State-owned company model been shown to be fundamentally inferior to that of the privately owned model. Instead, privatisation emerges from this study as a useful, sometimes powerful, political and economic tool if and only if used selectively, in conjunction with other deregulatory techniques and without ideological bias. By introducing or widening contracting-out, franchising, joint ventures, voucher schemes or other forms of privatisation discussed in Chapter Two, increased competition and enhanced efficiency may result. For each industry the government must select the appropriate form of deregulation and compare the expected gains to the real costs, financial and social. This thesis reported many cases where the apparent gains from privatisation have been unequally distributed and, besides, short lived.

Part Two examined a number of privatisation programmes around the world. The British programme has been pioneering and widespread. A large range of companies have been returned, in whole or in part, to the private sector. Others have been made private for the first time.In many cases increased competition, efficiency and profitability have resulted. However, these gains are not easily attributable to privatisation itself. Furthermore, the costs of the privatisation programme were huge and the gains to the exchequer were temporary. In many cases, the wider share ownership and the increased profitability of the companies concerned have also been temporary.

Chapter Four explored the varied styles of privatisation programmes in Europe, America and elsewhere. A universal procedure does not emerge. The programmes pursued by countries vary in their intensity, their significance and in their objectives. For many countries privatisation is used to reduce the costs of State intervention in the economy. For others it is a method of introducing capitalism or of widening competition. For some countries privatisation is an attempt to reduce the national debt. In some cases it is part of an IMF-backed restructuring of the nation's economy.

Privatisation has been sporadic and selective in most countries but widespread and intense elsewhere. The industries that are most often the subject of privatisation include the telecommunications industry, chemicals, banking and insurance, transport, aero-industries and car manufacturing. The success of the programmes varied from country to country. In those countries where levels of State intervention are high and public sector losses large, privatisation has failed to make a significant impact. In other countries, mostly in Europe, privatisation has succeeded in reducing the size of the public sector and in widening competition and consumer choice.

In no case has privatisation been a panacea for a nation's ills. This thesis has repeatedly emphasised that privatisation is not an autonomous economic or political tool. Privatisation alone will not improve efficiency or competition nor improve the exchequer's long-term finances.

Yet privatisation remains an important ingredient in the process of deregulation and liberalisation. When used alone, privatisation will achieve little. When used together with other pro-competitive strategies, privatisation can contribute to the enrichment of an economy's competitiveness and to the betterment of general welfare.

Chapter Five explored the background to Ireland's public sector and the opportunities for privatisation. Unlike other chapters, some of the discussion was speculative or aspirational. Privatisation remains a largely unexplored policy in Ireland. The success of the two major flotations in 1991 and the concerns that follow the business scandals of the same year mean that Ireland will remain interested but cautious in its approach. Divestiture will not solve the nation's debt and unemployment problems but, if used selectively and carefully, may enhance competition and widen the opportunities for growth.

The remainder of this chapter briefly summarises the conclusions of this dissertation with particular concern for the prospects for Ireland's infant privatisation programme.

A precise summary of the ideal privatisation procedure is not possible. The privatisation programmes discussed in Part Two vary considerably. The characteristics of each country's political structure, industrial profile, national finances, social priorities and economic strengths have determined the speed and extent of their privatisation programmes. A definitive pattern has not emerged. However, Ireland's programme may benefit by considering some of the lessons of other countries. The following is a summary of the ingredients for a successful programme.

A successful privatisation programme requires a committed political will to carry it through. The determination of the Thatcher and Chirac governments greatly enhanced their respective programmes. But ideological fervour is not enough. Privatisation will only succeed if the public understands its economic sense. Public support is necessary to provide finance for the change of ownership. The political and public support must also be backed by the enthusiasm of the business sector, particularly the large financial companies who are likely to become investors. It is also important that workers and management of the targeted companies support the change. To achieve this general support the government must carefully consider the share offer price and the employee share options in the case of a flotation. Where a trade sale is favoured, the government must consider the plans of the prospective buyer. The concerns and expectations of management and employees must always be taken into account.

In Ireland the 1991 flotations of Irish Life and Greencore received general approval but aroused little debate. Further privatisations of such companies as Telecom Eireann, Aer Lingus and the ESB will attract widespread discussion and considerable opposition. These privatisations will only succeed if built around sound economic reasoning. The Irish public will support individual privatisation projects only if the expected gains in competitiveness, employment opportunities and exchequer finances outweigh the social and private costs. In part a successful privatisation programme builds upon its own success. Where privatisation has already introduced real improvements in price, quality and efficiency, further privatisations are likely to receive wide support. To win this support, an Irish government must not rely on the argument that the revenue gained will directly offset the national debt. This thesis has shown that the long-term net revenue gain from privatisation is, at best, zero. The government's arguments must remain specific to each separate venture. The need to enhance competition, allow access to investment funds and encourage growth ought to be the core message. The British privatisation programme continues to arouse opposition because it appears that the only ones to gain from the programme are the investors and the company's executives. Future Irish privatisations must be seen to benefit the ordinary consumer as well as the shareholder and to offer hope for the unemployed and the under-privileged.

Great care must be exercised in choosing the format and the target of the early privatisations. The programmes of France, Spain and Britain, for example, began well. Popular support was generated in the early stages. Chapter Three explored the elaborate promotional campaign exercised for the first flotation of British Telecom. This generated great enthusiasm and support for a highly complex sale. The successful flotations of British Gas, the Electricity Supply Industry and the Water Industry were only possible because of the early success of the BT sale. Chapter Four reported on the competent privatisation legislation that created early confidence in the programmes of France, Poland and Canada.

Ireland's privatisation programme also began well. The flotations of Irish Life and Greencore were performed compentently. The offer prices of the shares were well judged. These denationalisations were relatively well received. Chapter Five recorded how Ireland's privatisation programme has since suffered from a series of scandals and allegations about the affairs of Irish Sugar and Telecom Eireann. The apparent absence of ethical business practices and the lack of complete and early information have set back confidence in future flotations.

The next divestiture of an Irish State-owned enterprise will be more difficult than any before. A strong profitable company with no obvious social charter ought to be chosen. Aer Rianta, together with GSH, may suit. The government will need to assure the public that the privatisation is of benefit not only to the company and the investors but to the tax-payer, the consumer and the socially disadvantaged. Economic and social reasoning must be seen to triumph over politics.

Chapter Two explored the varied forms of privatisation. An Irish government must examine all of these options. Apart from the high profile flotation methods, forms of contracting-out and franchising services should be assessed. Where possible, truly competitive bidding must be allowed. In-house and intra-departmental tendering should also be facilitated. Perfect contestability should be the goal. In some cases the extension of voucher schemes and of user-charges may be appropriate. These help to reduce the public's dependence on the State and to reduce the cost of the public sector. But they may be inequitable. A firm case for any of these methods must be asserted from the start. Privatisation or deregulation in education, health, security or local services must not proceed unless it is clearly shown that the general public can benefit directly or indirectly in the medium term. The private and social gains must clearly outweigh the costs.

The government should encourage further joint ventures between the private sector and the semi-State sector. SOEs such as Telecom Eireann, Aer Lingus and Aer Rianta are successfully developing their portfolio of joint ventures. These allow the firms to widen their competitiveness. They indicate a company's likely fortunes after privatisation.

Flotation remains the most widely understood form of privatisation. Future privatisations in Ireland are likely to involve the sale of State-owned shares to the public. Chapter Two examined the difficulties of the various methods of divestiture. The merits and demerits of a trade sale, a private placing, an EBO and an MBO and of a share issue were explored. A trade sale is often inexpensive and uncomplicated. It may, however, lead to the ownership of the asset going abroad. The same may be said of a private placing. An EBO or MBO is likely to prove most popular within the company itself. Either arrangement may best guarantee the retention of staff, expertise and commitment. On the other hand, either may retain all of the inherent problems of the firm and revenue is unlikely to be maximised.

A general share issue contains a considerable and widespread risk for investors and for employees. Chapter Two discussed the pricing options in a flotation. If possible, the company's shares should be issued in tranches. Early tranches can be sold by competitive bidding. Subsequent tranches may be fixed price, building on the initial tender price and on the current market price. This strategy maximises revenue while satisfying the goal of wider share ownership. Alternatively, a second or subsequent tranche of shares could be sold through the fixed discount method. A major advantage of this method is that costs, particularly underwriting costs, are minimised.

Any privatisation programme in Ireland should be complemented with a variety of strategies that encourage competition. Privatisation should be considered as only one element in the set of policy options. Specific deregulation should be assessed and then applied where appropriate. For a start, the government ought to reveal, in detail, the degree of cross-subsidisation exercised by Ireland's SOEs. This would reveal the extent of anti-competitive policies exercised in the economy. In each instance of cross-subsidisation, the effects of its use and the likely effects of its withdrawal should be examined by an independent agency. It may emerge that social benefits of specific cross-subsidisation greatly outweigh the probable costs of its removal.

Privatisation emerges from this study as a worthwhile, sometimes powerful ingredient in the restructuring and revitalisation of an industry. In many cases just the threat of privatisation or the process of privatisation can lead to the desired improvements in efficiency, adaptability and competitiveness. In many other cases privatisation is inappropriate. It can be destabilising and inequitable. In all events, privatisation is not a self contained policy. Its merits rely firmly on the government's ability to weave a number of deregulatory policies, of which privatisation may be one, in order to create a true liberalisation of markets and a healthy freedom to choose.