

PRIVATISATION POTENTIAL IN THE EUROPEAN UNION

Proceeds and Productivity Effects

October 2014

On Behalf of United Europe



Privatisation Motives

- Public budget relief
 - Reduce debt
 - Mitigate fiscal obligations
- Capital market impulse
 - Enhance liquidity
 - Attract foreign investors
- Productivity enhancement

Private Ownership vs. Public Ownership

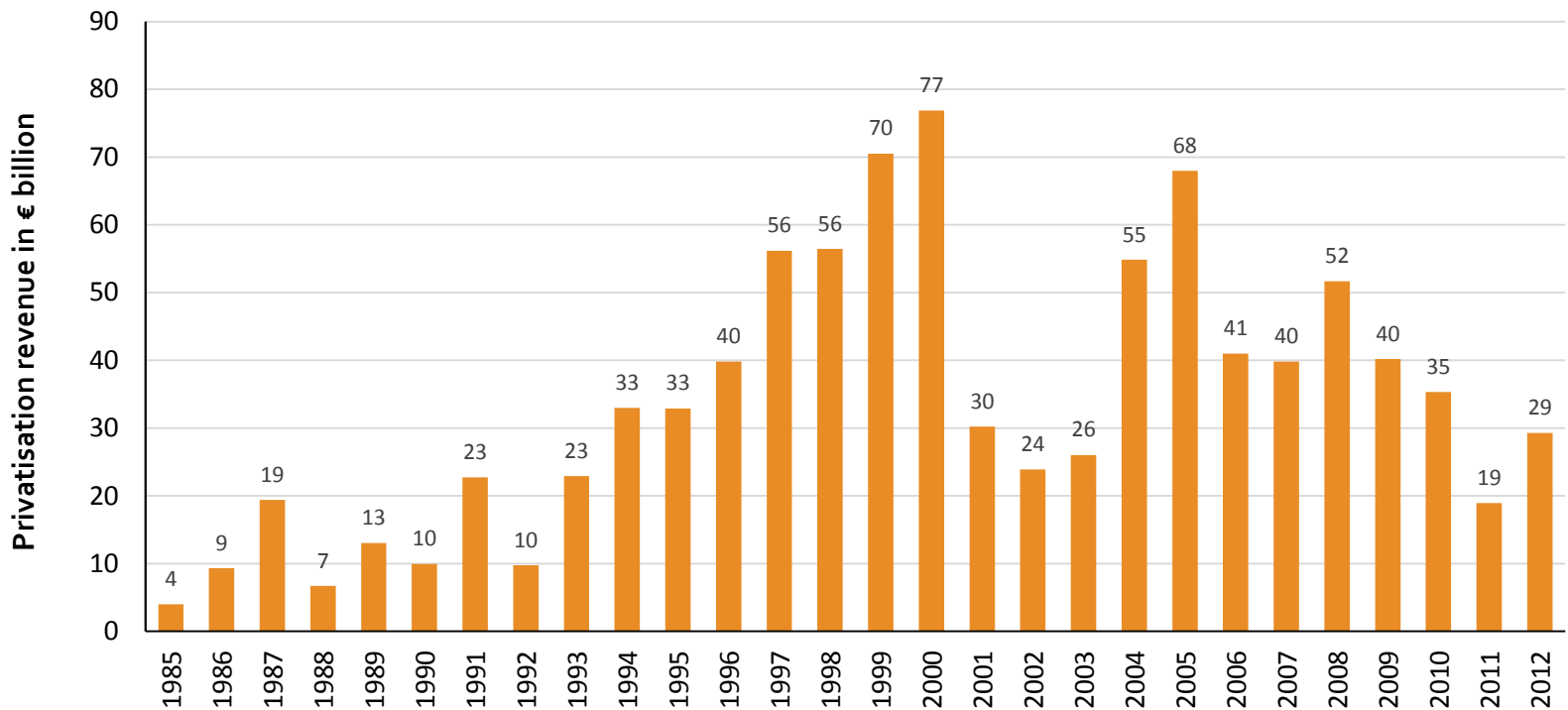
- *Information (asymmetries)*
 - Private owners seek to collect performance-related information
 - Effective reactions to management performance likely
- *Incentives*
 - State-owned firms may face soft budget constraints
 - The market for corporate control acts as a disciplining device
- *Objectives*
 - Competitiveness as primary firm-level objective
 - Rival objectives in the political sphere

Privatisation: Empirical Evidence

- Firm-level productivity and profitability rise, debt levels decrease
 - Empirically confirmed by numerous studies for various countries and sectors, e.g. La Porta and López-de-Silanes, D'Sousa and Megginson.
- Stimulating effect on domestic capital markets
 - For instance, shown by Megginson and Netter.
- Ambiguous findings for short-term employment dynamics
 - Empirical studies focus on effect three years after privatisation
 - Employment increases found e.g. by Boubakri and Cosset, Megginson, Nash and Randenborgh, employment declines e.g. by La Porta and Lopez-de-Silanes.
- Positive effects on innovation
 - See Munari and Sobrero for a study on the effect of privatisation on innovation in the European Union.
- Conditional impact on consumer prices
 - Impact dependent on effective competition policy and sound regulation.

Waves of Privatisation

- Top three privatisation countries 2012: Portugal (€ 8.59 bln), Ireland (€ 7.18 bln) and Italy (€ 3.97 bln)



Source: Privatization Barometer. The number and volume of privatisations between 1985 and 2012 are shown for the EU-27 countries.

Limits to Privatisation

- Privatisation is recommended for all industries which can be disciplined by
 - competitive forces and/or
 - effective regulation.
- Physical network infrastructure may constitute a natural monopoly
 - Private ownership of physical network infrastructure is nonetheless possible;
 - Challenges: an effective regulatory design has to be implemented, ensuring appropriate investment activity and maintaining standards of safety and service quality.

The EU Privatisation Potential I

- 10 largest Eurozone members according to GDP:
DE, FR, IT, ES, NL, BE, AT, FI, GR, PT
- 4 non-Eurozone member states
UK, CZ, PL, RO
- These countries encompass
 - **90% of the overall EU GDP and**
 - **89% of the total number of employees!**
- Several thousand firms screened, in-depth analyses of 350 companies; 263 companies included in the study.

The EU Privatisation Potential II

- Listed state-owned firms account for 3.9 million employees (1.8% of total EU employment) and for a turnover of € 1.5 trillion (7% of turnover in the total business economy excl. banking and insurance)
- Non-listed, non-financial state-owned companies account for 0.7 million employees (0.3% of total employment) and for a turnover of € 0.15 trillion (0.7% of turnover in the total business economy excl. banking and insurance).

Privatisation Potential: Scope

- Government share in firms held by:
 - National/federal government
 - Regional government and
 - Municipalities
- Production and service sectors that are potentially competitive or can be regulated effectively.
- Expected positive discounted cash flow (NPV) without having to rely on subsidies.
- Firms with a turnover of at least € 100 mln.

Valuation Methods

- Listed firms
 - Average closing price in 2013
- Non-listed firms
 - Firm value of *non-financial institutions*:
DCF analysis and **valuation by multiples**
Net debt has been deducted to obtain the value of equity.
Price-to-book ratio of the relevant peer group.
 - Firm value of *financial institutions*:
DCF valuation unreliable
Valuation by multiples: Price-to-book ratios and
P/E-ratios of peer group median valuations.

Market values of public stakes in large enterprises

Government Stakes Worth € 511 bln

Country	Listed firms	Non-listed firms	Non-listed financial institutions	TOTAL
AT	8.2	11.1	-	19
BE	11.2	1.8	8.8	22
CZ	7.8	2.9	0.4	11
DE	49.0	7.9	19.0	76
ES	3.4	32.6	-	36
FI	17.7	10.1	-	28
FR	85.8	18.2	1.2	105
GR	5.7	1.6	-	7
IT	12.9	17.2	28.7	59
NL	-	22.7	36.4	59
PL	15.3	0.5	-	16
PT	0.7	2.2	6.8	10
RO	4.6	3.8	-	8
UK	50.9	4.0	-	55
TOTAL	273.1	136.4	101.3	511

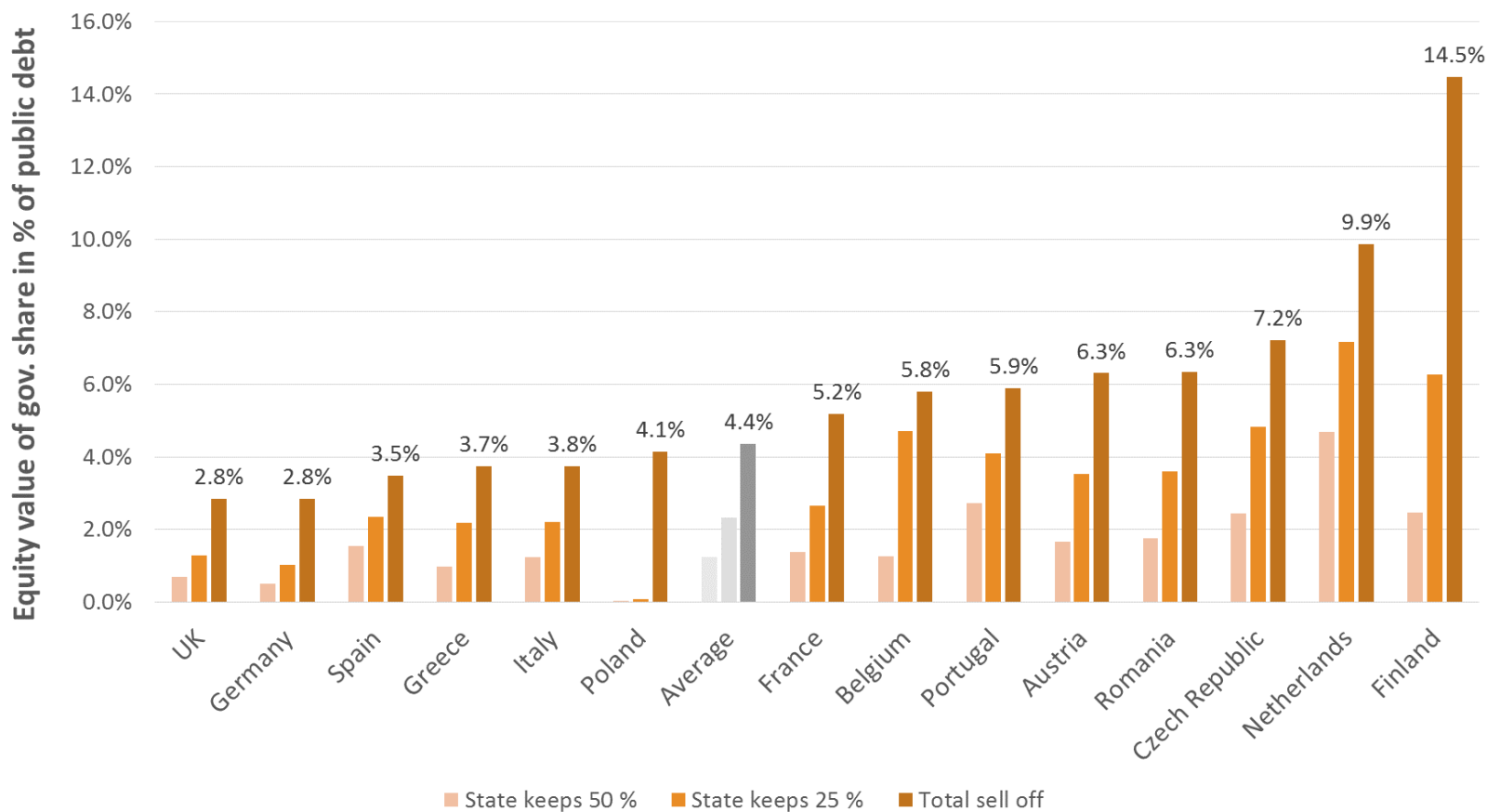
Source: Economica. Note: Numbers may not add up due to rounding.

Privatisation Scenarios

Country	Complete sell-off	State keeps 25%, whenever still possible	State keeps 50%, whenever still possible
AT	19	11	5
BE	22	18	5
CZ	11	7	4
DE	76	28	13
ES	36	24	16
FI	28	12	5
FR	105	54	28
GR	7	4	2
IT	59	34	19
NL	59	43	28
PL	16	0	0
PT	10	7	4
RO	8	5	2
UK	55	25	14
TOTAL	511	272	145

Source: Economica.

Public Debt vs. Expected Proceeds



Source: Economica.

Productivity effects

Productivity Gains Through Privatisation

Empirical studies show that the privatisation of public enterprises leads to a sizable increase in labour productivity subsequent to privatisation.

	Number of observations	Real Sales per Employee	
		Mean change after privatisation	Median change after privatisation
Meggison, Nash and van Randenborgh (1994)	51	11%	12%
Boubakri & Cosset (1998)	56	25%	24%
D'Souza & Megginson (1999)	63	21%	29%
Weighted average	170 in total	19%	

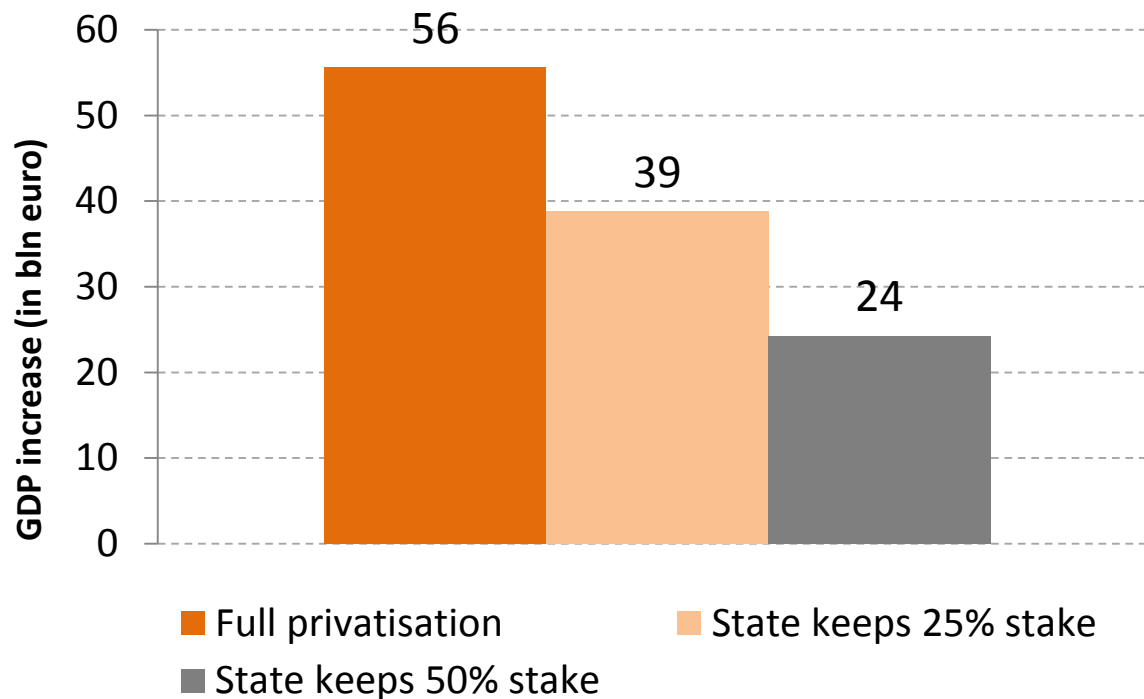
Source: D'Souza and Megginson (1999). Note: The mean change after privatisation refers to the change in real sales per employee comparing the three years before privatisation to the three years after privatisation.

Privatisation, Productivity, and Growth I

- The privatisation of non-listed firms in the fourteen member states would generate 103.7 billion euro in revenue if the state keeps a 50% stake.
- Given the expected productivity increase, GDP would rise by € 24 billion.
- Privatisation entails a **permanent upward shift in European GDP by 0.21%.**

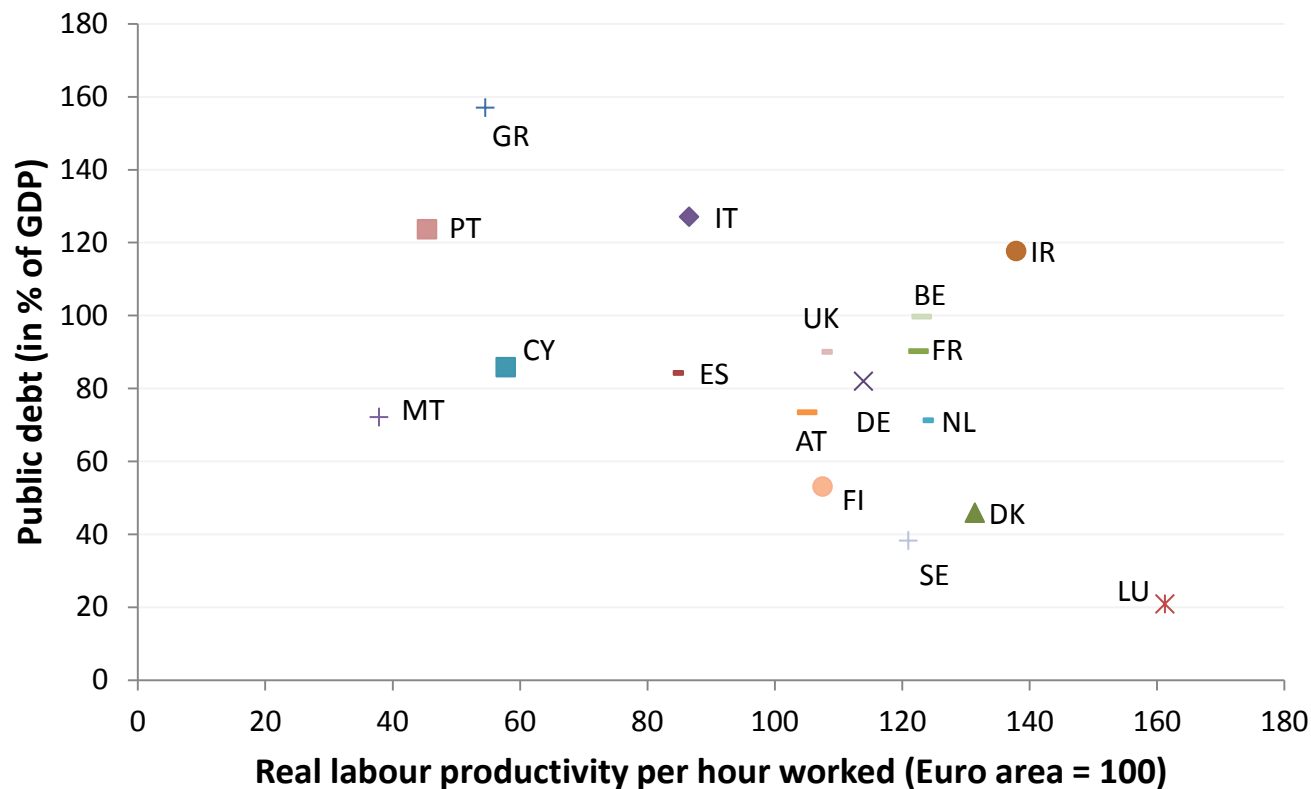
Privatisation, Productivity, and Growth II

- Complete privatisation of non-listed firms in the fourteen member states leads to a persistent increase in GDP by 56 billion euro. If the governments keep a 25% stake, the increase in GDP is equal to 39 billion euro.



Public Debt vs. Labour Productivity

Negatively correlated!



Source: Eurostat. Public debt (as a percentage of GDP) and real labour productivity are shown for the EU-27 member states with the exception of the Eastern European countries using the values for 2012.

Privatisation candidates: Highlighting the productivity potential

Privatisation: The Productivity Resource I

■ Aviation

- Int'l airports in Germany (DE): Hamburg, Erfurt-Weimar, Nuremberg, Saarbrücken, Cologne/Bonn, Stuttgart, Dresden, Hanover
- Finavia (airport operator, FIN)
- Cesky Aeroholding (aviation holding, CZ)

■ Mining

- Empresa De Desenvolvimento Mineiro (mining, PT)
- Societatea Nationala a Sarii Salrom (salt mine, RO)

■ Shipping / ferries

- David MacBrayne (ferry service, UK)
- FinFerries / Suomen Lauttaliikenne (ferry service, FI)
- Arctia Shipping (ice breaker & ferry service, FI)

■ Postal service

- Correos (postal service, ES)
- Hellenic Post / ELTA (postal service, ES)

■ Television

- RAI - Radiotelevisione Italiana (TV station, IT)
- France Televisions (TV station, FR)

■ Miscellaneous

- Meissen porcelain (porcelain producer, DE)
- LFB (biotech industry, FR)
- Hidroelectrica (electricity generation, RO)

Privatisation: The Productivity Resource II

	Difference to EU benchmark in %	Difference to national benchmark in %
International airports Germany *)	-57.6%	-56.1%
Finavia	-62.9%	n.a.
Cesky Aeroholding	-48.4%	-55.8%
EDM - Empresa De Desenvolvimento Mineiro	-91.3%	-65.7%
Societatea Nationala A Sarii	-82.7%	-28.5%
David MacBrayne	-74.4%	n.a.
FinFerries Suomen Lauttaliikenne	-69.0%	-42.8%
Arctia Shipping	-57.2%	-21.0%
Correos - Sociedad Estatal Correos Y Telegrafos	-44.8%	-35.8%
Hellenic Post / Elta	-21.0%	-25.1%
RAI - Radiotelevisione Italiana	-19.6%	-39.7%
Staatl. Porzellan-Manufaktur Meissen	-66.2%	-71.8%
LFB	-42.8%	-48.6%
Hidroelectrica	-90.5%	-37.8%

Source: Economica, Eurostat.

*) Hamburg Airport has been chosen to calculate the difference to the benchmark

Privatisation Outlook

- Ambitious stock market valuations make privatisation even more attractive.
- If privatisation is to succeed, it has to return in a new guise:
 - Utmost transparency (“privatisation monitor”)
 - Further professionalised processes (“best practices”)
 - Auction-type public selling procedures
 - Avoidance of covert privatisation
 - Independent and effective regulatory oversight of post-privatisation market conduct.

Privatisation in a Nutshell

- Microeconomic efficiency gains
- Funding source for investment
- Effectiveness of growth-enhancing measures is higher when public and private debt are lower

→ Triple dividend from privatisation

- Enhanced European competitiveness and renewed growth prospects.

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