PRIVATISATION POTENTIAL IN THE EUROPEAN UNION

Proceeds and Productivity Effects

October 2014

On Behalf of United Europe

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Privatisation Motives

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

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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

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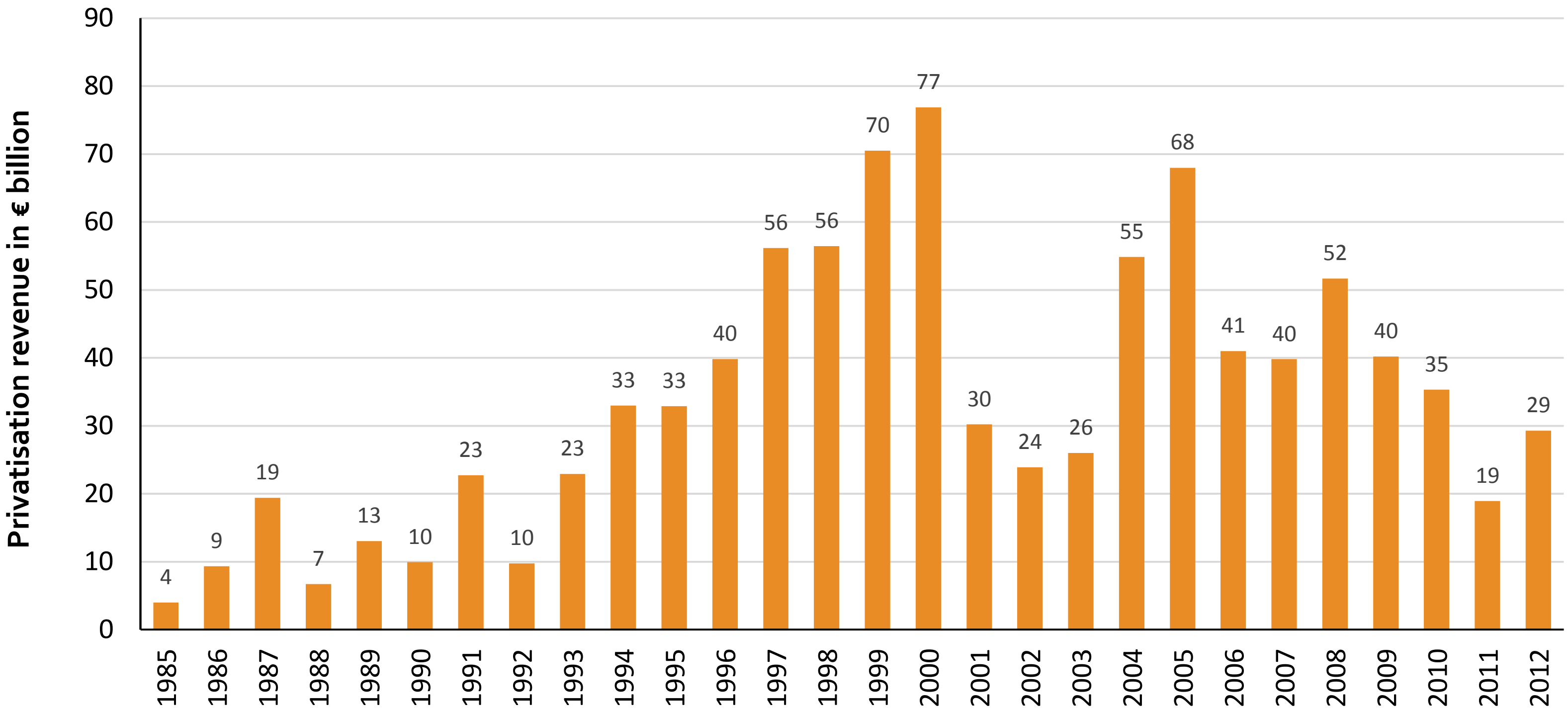
Privatisation: Empirical Evidence

- 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)



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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.

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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.

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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).

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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.

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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**

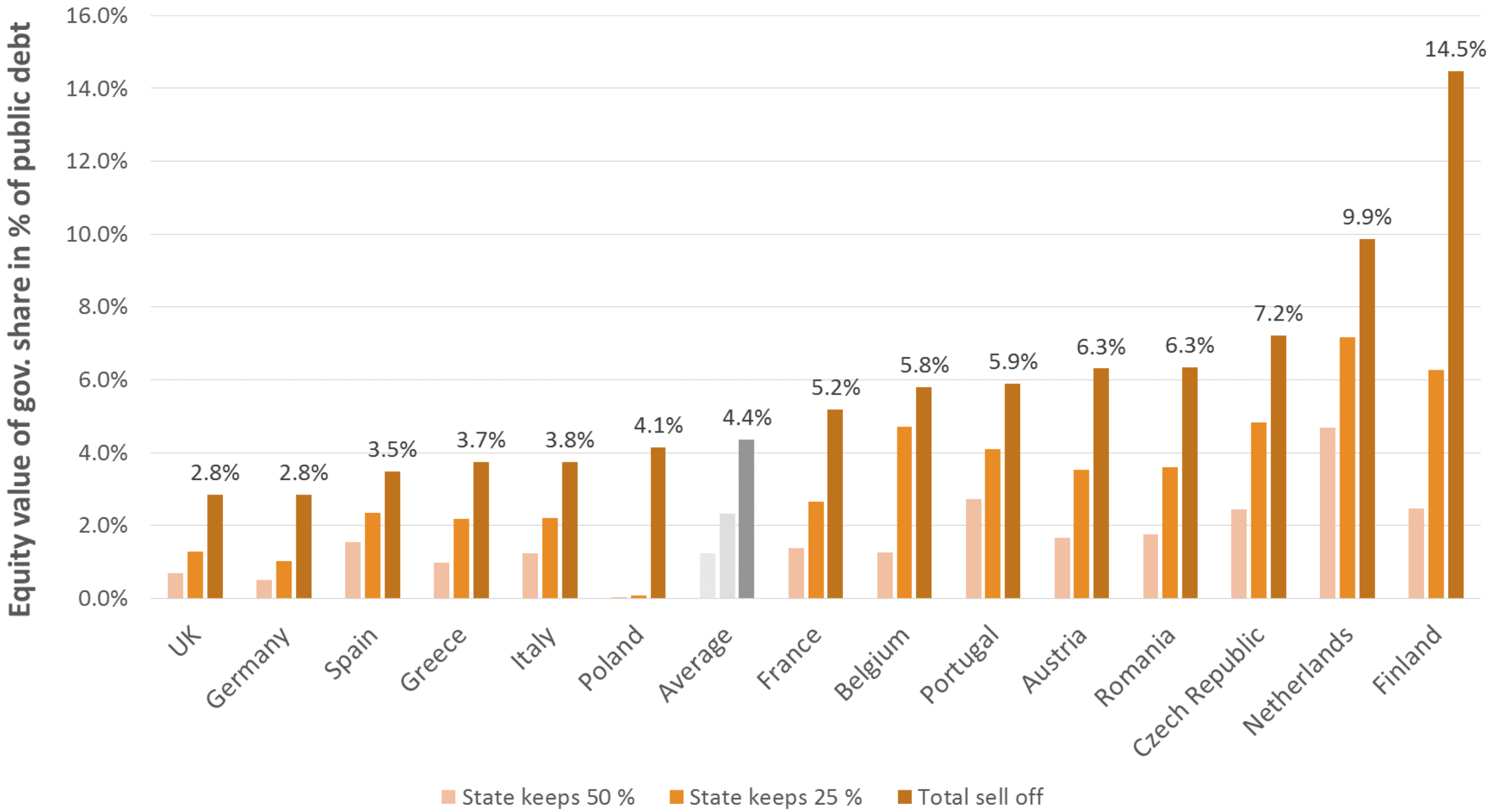
Source: Economica. Note: Numbers may not add up due to rounding.

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.

	Real Sales per Employee		
	Number of observations	**Mean change after privatisation**	**Median change after privatisation**
Megginson, 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%	

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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%**.

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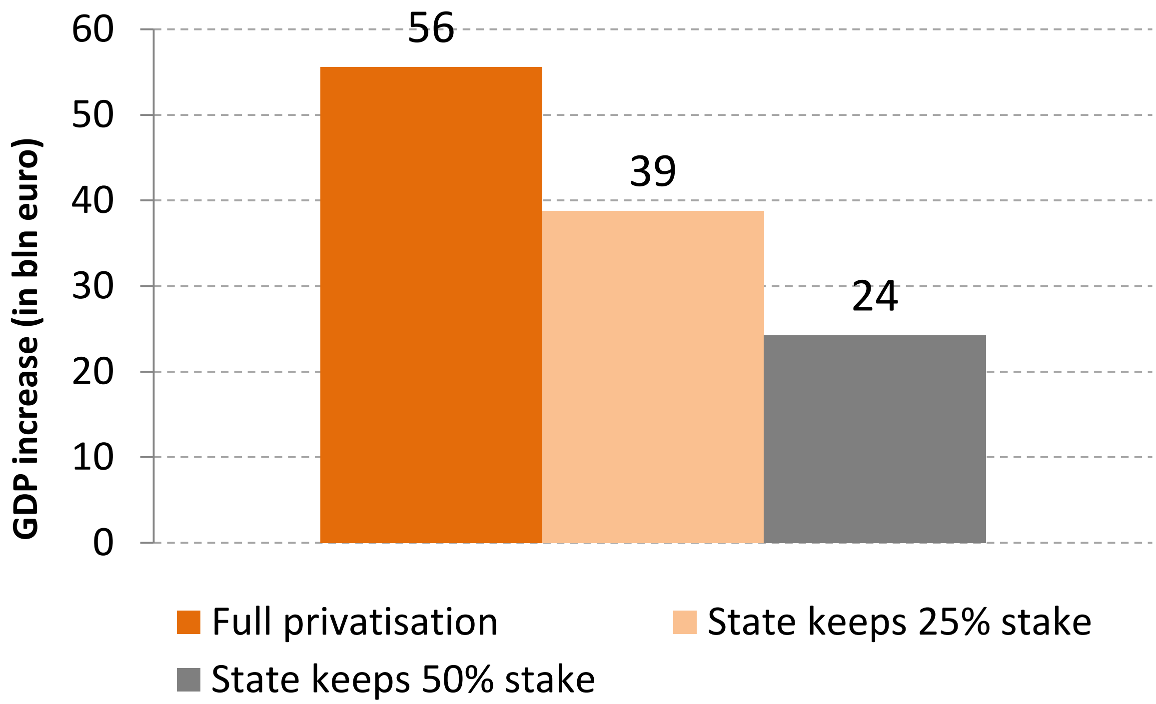
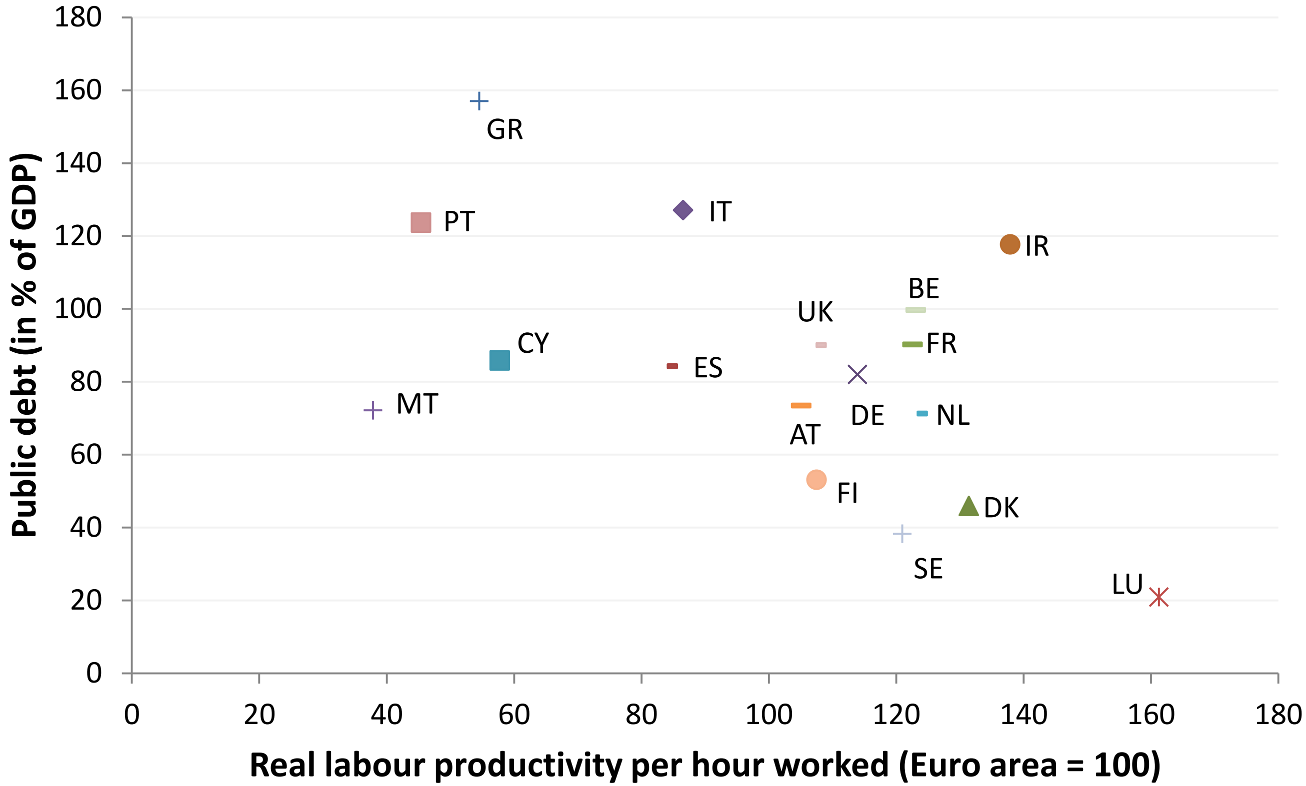
Privatisation, Productivity, and Growth II

- 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, Saarbrucken, 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%

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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.

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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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