Article: Selling the State Assets – Some considerations

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State enterprises in Ireland have received considerable attention in recent weeks and months due to the value that they might represent to the Irish government. This value could greatly assist in reducing either National Debt or the Budget Deficit. However, such urgency has not always been required. Indeed, in the past the sale of Irish state assets was typically viewed through the evaluation and consideration of some economic criterion. In this article, Dr. Michael Tobin outlines the typical criteria and considerations leading to arguments being put forward in favour of the sale of state assets (known commonly as privatisation) and some arguments against.

An Taoiseach (The Irish Prime Minister) has said that the sale of State assets is expected to begin next year, where the "The objective of the (Irish) Government is to have a limit, reaching €3 billion, for the disposal of assets at the appropriate time and the best opportune price for the State." This has been agreed with the 'Troika' (representatives of the International Monetary Fund, European Union and European Central Bank). Furthermore, An Taoiseach has advised that the Minister for Energy and Natural Resources will present a list of recommendations to the Government in respect of the disposal of Bord Gáis Energy (the state owned – primarily gas company) and some elements of the power-generation capacity within the ESB (the state owned – primarily electricity company). In addition, the sale of some Coillte's (the state owned forestry body) assets will be considered.

This, in effect, is being carried out in Ireland at this time in order to release much needed funds as the government continues to try and manage the ever increasing deficits that Ireland is currently running, both national debt and budget deficit. However while attempting to resolve the current malaise, it must also be remembered that once the assets are sold that they are gone and consequently the national exchequer's access to such funds going forward, has been diminished. In recognising this, it is imperative that decisions are not taken based solely on a short term gain, but that they also involve the consideration and evaluation of the typical reasons and arguments put forward for and against the sale of state assets, commonly known as *privatisation*.

In essence, privatisation involves selling state owned assets to the private sector. This is often achieved through listing the new private company on the stock market. In recent history, Ireland has privatised Eircom (the state owned telecommunications company) and Aer Lingus (the state owned airline company) and this has not always been viewed by the many stakeholders in Ireland with a positive lens, even when in better economic times. Acknowledging this, consideration must therefore be given to the following questions prior to embarking on further privatisations:

- Will this be right for the organisation's involved?
- What are the supposed benefits to be gained from privatisation?
- What are the supposed downsides to such privatisation?
- Who are the stakeholders (society at large, future generations, environmental considerations etc.) that should be considered and what is the likely impact on them?

A final decision should only be made following careful consideration of the above questions.

So what have been the traditional arguments put forward by economists?

Economists throughout the ages have held that to privatise corporations will lead to the following advantages:

1. Improved Efficiency, based on the notion that private managers are more concerned with the profit motive than their counterpart in the state organisation.
2. A Lack of Political Interference where it is argued that governments make poor economic managers. They are motivated by political pressures rather than sound economic and business sense.
3. Long Term View. The argument that a government may think only in terms of the next election. Therefore, they may be unwilling to invest in infrastructure improvements which will benefit the firm in the long term because they are more concerned about projects that give a benefit before the election and in the short term.
4. Shareholder Pressure. It is argued that a private firm has pressure from shareholders to perform efficiently. If the firm is inefficient then the firm could be subject to a takeover. A state owned firm doesn't have this pressure and so it is easier for them to be inefficient, it is argued.
5. Increased Competition. Often privatisation of state owned monopolies occurs alongside deregulation – i.e. policies to allow more firms to enter the industry and increase the competitiveness of the market, leading to contestable markets. It is this increase in competition that can be the greatest spur to improvements in efficiency. For example,

there is now more competition in telecommunications and in the distribution of gas and electricity in the United kingdom, following privatisation. However, privatisation doesn't necessarily always lead to an increase in competition; this can depend on the nature of the market. For example, there is very little competition within the rail industry in the United Kingdom. This increased competition argument then largely depends on the market domain.

6. Raising Revenue. The government will raise revenue from the sale. However, this is a one off benefit. Furthermore, the implication is that the state, and arguably wider society lose out on future dividends from the profits of public companies.

Disadvantages of Privatisation are:

1. Fragmentation of Industries. In the United Kingdom, rail privatisation led to breaking up the rail network into infrastructure and train operating companies. This led to areas where it was unclear who had responsibility.
2. Natural Monopoly. A natural monopoly occurs when the most efficient number of firms in an industry is one. Therefore, in this case, privatisation would just create a private monopoly which might seek to set higher prices which might exploit consumers. Therefore, it is better to have a public monopoly rather than a private monopoly which can exploit the consumer, as the theory is that the public monopoly will have a fair pricing strategy. Additionally, the requirement to offer basic services such as telecommunications, electricity and water might not exist if the return is considered as being too low by the private monopoly, whereas there is typically an obligation on the part of the public monopoly.
3. Public Interest. There are many industries which perform an important public service, e.g. health care, education and public transport. In these industries, the profit motive shouldn't be the primary objective of firms and the industry.
4. Future Dividends. Following privatization government loses out on potential dividends. Many of the companies in Ireland discussed at present for privatisation have been financially successful in recent years or their assets will deliver a financial reward in the coming years. This means, following privatisation, the government will miss out on their future dividends. Dividends going to wealthy shareholders instead.
5. Regulation. Privatisation creates private monopolies. These need regulating to prevent abuse of monopoly power. Therefore, there is still need for government regulation, similar to under state ownership. Currently, this regulation is carried out by the Irish Competition Authority where Irish Competition Law is embodied in the Competition Act 2002.

6. Short-Termism. As well as a government being motivated by short term pressures, this is something that may affect private firms too. In order to please shareholders a private firm may seek to increase short term profits and avoid investing in long term projects. This can be seen in returning large dividends to shareholders or the drawing down of large salaries!

In summary, the value to be achieved from privatisation, depends on the industry in question. An industry like telecommunications is a typical industry where the incentive of profit can help increase efficiency. However, if it is applied to industries like health care or public transport the profit motive is less important. Additionally, it depends on the quality of regulation. Are regulators able to ensure that the privatised firms meet certain standards of service and keep prices low? One should also consider whether the market is contestable and competitive? Creating a private monopoly may harm consumer interests, but if the market is highly competitive, there is greater scope for efficiency savings.

Looking therefore at the current indicative proposals/soundings in Ireland focusing mainly on Bord Gais, ESB and Coillte, it is important that in advance of making any decision or outcome that the policy makers focus on the broader issues surrounding the sale of assets, as opposed to taking a narrow view of reaching " €3 billion, for the disposal of assets."

Finally, in the case of Ireland, all the stakeholders must be aware of the motives behind privatisation and where and when the funds earned will be spent. Will they be spent on initiatives for job creation and innovative supports to assist the economy in growing into the future? Will they be spent on current or capital expenditure? Or, will they be spent on the national debt or budget deficit? Remember, national debt and budget deficit are terms that often get used interchangeably, but they are not at all the same thing. The budget deficit representing the shortfall between what the government spends during a single year compared with what it brings in during a single year. The national debt, on the other hand, is the accumulation of all the budget deficits for every year since the Irish State has been in existence. Debate, discussion and answers to these questions in the current economic climate are as important as the arguments raised for consideration above.