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REFORMING PUBLIC ENTERPRISES

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REFORMING PUBLIC ENTERPRISES

1. The reform of public enterprises is a key element of overall public sector reform programmes. Most Member countries have applied the policy instruments of commercialisation, corporatisation and privatisation to the public enterprises sector.

2. This study seeks to outline the experiences of six Member countries with reforming public enterprises: Australia, the Netherlands, Norway, Spain, Switzerland and the United Kingdom. The following overviews provide a brief introduction to each case study and highlight the reform efforts in each country. The full case studies are contained in the accompanying report, *Reforming Public Enterprises - Case Studies*.

Australia

3. The Australian federal and state governments were comparatively late in beginning their public enterprises reform programmes. Until the late 1980s, the degree of government intervention in Australia continued to rival that of the United Kingdom prior to reforms. Almost 10 percent of Australian GDP, and 17 percent of net capital stock could be attributed to government businesses. The federal and state governments were the sole suppliers of utilities and communications for most of the country. The progression by which Australia has moved from its interventionist stance to its current reforming policies is imbued with distinctly Australian elements, yet many are applicable in other settings.

4. A unique element to the reform of public enterprises in Australia can be seen in the original government objectives for involvement. Early in Australia's development, the government saw that the risk of major developments in such a large, yet sparsely populated country, may have meant that without government involvement certain needed products, most notably in the utilities and transportation sectors, may have gone unprovided by the market. This led the government to take over many of Australia's incipient transportation systems, and to later develop and maintain the energy utilities in each state.

5. With the rationale of government intervention dissipated by better communication and transportation links and the continuing growth and development of the Australian economy, the door was opened to reforming government involvement. Yet, it was not before several significant economic crises (including a recession and state bank crises) and a fundamental change in attitude at all governmental levels, that formal reforms began. The resulting four-part policy is one of the more nuanced and multi-faceted reform efforts in the OECD community.

6. The first branch of reform comes under the title "commercialisation" and calls on a public service or a statutory authority to operate, as much as possible, on a commercial basis. This broad directive can result in behaviour as varied as public agencies contracting out different services, or even in some cases, selling certain services on the market. This reform does not require any change in ownership or liability, both of which remain solely the responsibility of the controlling government. Closely related to commercialisation, and requiring greater organisational and, at times legal, reform is the Australian version of "corporatisation." Used extensively in the state of New South Wales, in this implementation,

corporatisation requires departments or authorities to separate services that “are, or could be” delivered in the market and legally establish new commercial entities, apart from, although owned by, the government. This form of corporatisation enacts a whole range of other legal changes, often including the division of regulatory responsibility and production, making these new industries even more like those in the private sector, which is the overall goal of the strategy.

7. Privatisation serves as the third part of the reform policy, and although it appears analogous to similar policies in other countries, this element has a distinctly Australian component. Even though the trade sale-dominated privatisations have been successful in securing significant financial gains for the tendering government, the Australian tax system can be blamed for the sluggishness with which it has been implemented. The states ceded income tax powers to the federal government in 1942, and thus the states are comparatively weak in generating revenue. The businesses which the states own are usually not subject to taxation by the states, but the states secure revenue from them via “payments in lieu of taxes.” When states sell their corporations, they lose this power to generate income from the businesses, and any taxes generated by the private owners goes to federal, rather than state coffers. Thus, privatising industries, for many states, seemed a losing proposition, at least until the federal government formalised tax compensation, making up for at least part of the loss incurred by sales. Although limited, this tax compensation, led to significantly more privatisations, including the remaining state banks.

8. The final element of Australian reforms began in 1995, with the adoption by both federal and state governments, of the National Competition Policy. Comprised of three separate agreements, this is a comprehensive approach aimed at promoting competition in both the public and private sectors. While none of the three proposals within the policy are peculiar to Australia, their combination within a single law, and more importantly, the method by which the governments agreed to ensure implementation is unique. The state governments will receive “competition dividends” from the federal government for complying with the implementation schedule, greatly increasing the benefits for continued reform.

9. The success of the Australian reform strategies can be seen not only in unique elements of the National Competition Policy but also in the clear and ordered progression of the programme. Starting with the principles of commercialisation, and resulting in the ratification of the National Competition Policy, Australia has in a very short time developed a sophisticated reform policy that has rid its governments of burdensome industries and in many cases increased competition in the market.

The Netherlands

10. Major reforms in the Netherlands began in 1982 when the government formulated six “large operations” which aimed to investigate the role of the public sector and increase the effectiveness of government intervention. Privatisation, which for the Dutch includes the subsets of corporatisation and contracting out, was one of these operations, and was formed from a desire to improve government finances.

11. From the beginning, the Dutch effort has been marked by a very apparent procedural element. Once a potential enterprise is selected for reform, the policy calls for the formation of a working group, complete with representatives of all concerned ministries. The group is required to consider all the options for, and effects of, reform. The working group then sends its report to a specialised committee on privatisation, the *Interdepartementale Begeleidingscommissie Privatisering* (IBP), which is charged with ensuring the coherency of reform strategies, and, importantly, serves as a clearinghouse for expertise on privatisation. Such bundling of knowledge has been rare in many other nations’ reforms. After the IBP’s recommendation, all documents are sent to the cabinet where final decisions are reached, and at least from 1983 until 1991, made public, in regularly published privatisation reports.

12. The Dutch are unique not only in the procedural style in which they proceed with their reforms, but also for the mandated questions that are asked prior to any privatisation project. These questions make the Dutch approach more holistic than others, bringing the government back to the beginning of its involvement with an enterprise, obligating the government to investigate why it originally intervened in the industry, and whether that rationale still exists today. This in-depth examination gives both a greater internal coherence to policies, and results in more sophisticated, and justified, reform strategies. External coherence with other domestic policies is provided by the centralised IBP, and internationally by the mandate that the Dutch government look at foreign experiences with an eye to learning from successes, and avoiding some painful pitfalls experienced by other nations. Although this foreign observation has been *de facto* policy in many countries, few have made the requirement explicit, and combined with intensive internal questioning, this has aided in the success of many Dutch reform efforts.

13. Dutch policy has developed over the past fifteen years, becoming more varied and, in some ways more powerful. What began solely as a privatisation exercise has become a procedure which has added different forms of corporatisation and contracting out to the policy mix. In fact, whereas corporatisation was once feared by the Dutch, for its assumed inefficiencies, it has now become the most common means of reform.

14. Despite this success, there have been significant problems with implementing public enterprises reforms. The primary concern has been the limited number of activities that were fit to be reformed immediately. This was due first to the unsure financial consequences of privatisation. The Dutch state enterprises, like those in many other countries, are plagued by archaic accounting systems which fail to take a true accounting of costs. Secondly, as the centralised government has a hand in all significant privatisations, a lengthy legislative process needs to be completed prior to any action. That each new potential privatisation is dealt with by company-specific legislation has been a primary cause of slowing down public reform efforts. Thirdly, the Dutch, again as in other countries, are hampered by the potential change in the legal status of employees. Unemployment at the hands of privatisation was, and often continues to be, unacceptable, and thus redundant employees are regularly offered other work in the civil service. This replacement, which often includes the writing of a “social plan,” and extensive negotiations with the unions, often takes significant time, and causes reforms to lag. Finally, there exists an intricate problem of fiscally transferring the reformed activities from the public to the private sector, as this has often resulted in untenable price increases. The government has offered financial assistance to offset these prices, and in some cases, reformed industries (especially those delivering “social” goods) have remained tax free, such that the prices they charge do not grow too quickly.

15. Although quantitative proof of the success of Dutch reforms remains scarce, there is increasing evidence that privatisation and corporatisation have improved productivity and quality of reformed enterprises. Such positive results can in part be attributed to the rigorous methodology that needs to be followed for each reform.

Norway

16. Norway has been a “hesitant reformer” of public enterprises. As a major oil producing nation, Norway’s public finances are in very good order. The need for fiscal consolidation has therefore not been a driving force for reforming public enterprises in Norway, as it has been in many other countries.

17. Total government ownership in Norwegian commerce and industry is extensive. The largest enterprise is by far Statoil, the state oil company. Founded in 1972, the company is responsible for the government’s interest as owner and operator in the extraction and production of oil and gas on the Norwegian continental shelf. Norway’s position as an oil nation led also to the establishment of the

Petroleum Fund in 1990. It will grow into a fund of substantial dimensions in the years ahead. Based on current assumptions, the fund will measure 130 percent of GDP by the year 2020. In its Revised National Budget for 1997, the government recommended that parts of the Petroleum Fund be invested in shares. It is to invest for “purely financial” objectives, thereby keeping holdings in the various companies at a low level. Given the size of the Petroleum Fund, the government will in the years ahead have a new role as a major equity investor in Norwegian and foreign commerce and industry. It is presently estimated that government holdings in companies listed on the Oslo Stock Exchange average about 20 per cent.

18. The government has large holdings in the financial services industry. The original rationale for state ownership in the banking industry was the need in the period after World War II to establish financial institutions which could contribute to social goals and promote economic development. These included the postal savings system (Postbanken), a housing finance bank (Husbank), and specialised investment banks for industry. However, a new situation developed with the onset of the banking crisis in the late 1980s and early 1990s. In order to prevent a financial collapse, measures were introduced in 1991 and 1992 to save several major banks. As part of these measures, the Government Bank Investment Fund was established in November 1991. As a consequence of the rescue operations in 1991 and 1992, the government became the dominant owner of the three biggest commercial banks in Norway. Rather than sell the banks once the crisis was over, the government decided to retain ownership in the two biggest banks. This was to secure a stable and national ownership of the banks and to ensure that central decision-making functions remained in Norway.

19. The government is involved in various other enterprises ranging from infrastructure enterprises such as telecommunications and electricity generation, to a pharmaceutical wholesaler and a forestry services company. Privatisation has never really been on the agenda in Norway. The few cases of privatisation that have been carried out have been government-owned manufacturing enterprises. The reform programme in Norway has centred around how to best manage enterprises while retaining government ownership. This discussion on modernising the public enterprises sector started in the mid 1980s and culminated in the study “A Better Organised State” in 1989. These reforms can be said to evolve around two principles. First, to split regulatory functions and commercial function into separate entities. Second, to organise state enterprises on a more coherent legal basis (corporatisation) and give them greater freedom of operations. For example, Norwegian Telecom, a government administrative enterprise that combined both commercial and regulatory functions, was split. The regulatory functions were transferred to a new Norwegian Telecommunications Authority while the commercial functions were incorporated as a limited liability company, Telenor AS.

20. As noted above, government finances do not exert pressure for reforming public enterprises in Norway. International agreements and obligations, technological progress, and the desire for greater freedom of action on the part of public enterprises are far more likely to prompt further reforms in this area.

Spain

21. Spanish public companies, with the exception of a few “Royal” corporations which were founded earlier, began operations in the early twentieth century, and were formed in order to guarantee the provision of certain public services. Two decades later, the Spanish government formed additional state enterprises, including banks and the telephone company, and began to use them as instruments of economic policy. This was the beginning of true government economic intervention, and puts Spain about twenty years “ahead” of many other OECD countries in implementing their nationalisation

programme. Yet, even though Spanish economic intervention started earlier, and in many respects remained longer, than other industrialised countries, the fast pace of reforms since the 1980s has meant that the size of the Spanish public sector, especially in terms of employment, has become comparatively smaller than many of its peers in Europe.

22. The progression from overly interventionist, to the current status of small and diminishing government involvement, came at the hands of three distinct phases of reform. Prior to the 1980s, Spain's publicly-owned business sector was comprised of three major holding groups. While one of the groups, which consisted of energy-related companies, was economically solvent, the economic fortunes of the other two oscillated with the fluctuations of the larger economy, and as a result were often a considerable financial burden on the government.

23. The first period of reform occurred alongside the economic boom of the late 1980s. The government used this time, and the resultant solvency of many state corporations, to privatise industries that were no longer of strategic importance. The beginning of the 1990s saw Spain fall into a deep recession, and the reform programme entered a second phase. Although they continued, reforms were now motivated by greater financial considerations, and the resumption of large and debilitating transfers from the government to the state enterprises. Though these first two waves of reform are similar to those that occurred in other OECD Member countries, the third wave of reform, which began in 1996, is unique. The election of a conservative government ushered in this new stage, which has seen the continuation and furtherance of privatisation due largely to the commitment of the ruling party to the reforms. While ideology has played a role in other nations' reforms, rarely has it been such a strong factor as it currently is in Spain.

24. Some of Spain's strategies for privatisation have been unusual. While many Spanish privatisations have pursued the traditional options of flotation or trade sale, Spain has also, at times, used an "implicit" privatisation strategy. This procedure involves a capital increase in which neither the government, nor publicly-owned companies, participate. Rather, outside investors are asked to raise capital, with the finances going directly to the company, both improving its financial situation and reducing the percentage ownership by the government, partially privatising the firm.

25. The second strategy, which has now become an accepted part of many countries' privatisation programmes, is Spain's desire to maintain the national character of its privatised entities. Rather than merely limiting foreign shareholding to a certain percentage, Spain has often established a group of "hard core" investors for these enterprises. These investors, usually an established group of domestic institutional shareholders, serve the dual purpose of guaranteeing the "Spanishness" of the corporation and centralising industrial financing decisions in a few national centres.

26. Spain also uses the policy tool of corporatisation regularly, combining it with other instruments and government goals. For example, it has used corporatisation as a means to allay direct government responsibility for enterprise debt. The current government's pace of privatisation may well ensure that no significant public sector enterprises will exist in Spain in the near future.

Switzerland

27. The unique political system of the country, which includes significant decentralised power and frequent use of referenda, has given Swiss reforms a very distinctive flavour. These factors have often been seen as limitations to reform. First, the fact that reforms have emanated from different levels of government, has led to a more "disorderly" process, yet it has also given voice to more ideas for reform. In

some instances, such creativity has been a boon to public policy. Additionally, although referenda do hold back certain efforts for some time, once they have been passed, reforms have been much more consensually and fully applied, with fewer political repercussions, than those in many other OECD Member countries. Indeed, despite the perceived difficulties that both federalism and the need for referenda have created, reform in Switzerland has been active. The Swiss case is characterised by the diversity of reform strategies present.

28. Given the size of the sector in the country, it is not surprising that a notable part of Swiss reforms have focused on the banking industry. Many banks, especially those run by the cantons, had a privileged position in the Swiss economy, which often included tax exemption and an unlimited cantonal government guarantee. While these safeguards were helpful in developing the banks, they were detrimental once the banks fell out of profitability. The Swiss have, on a fairly *ad hoc* basis, reformed this sector through trade sales, flotations and other means.

29. Various types of corporatisation have also been tried and planned (including a large-scale experiment with the Post Office commencing in 1998), and the Swiss are alone among the countries in the study for having an explicit proposal for future corporatisations of some government activities. In 1996, the federal government adopted the report *Führen mit Leistungsauftrag und Globalbudget*, which led to the foundation of the FLAG programme. This programme models a new form of public sector management, with the overall aim of increasing the autonomy of government departments in the hope of improving efficiency. The offices chosen for the experiment (thus far very few), are to some degree transformed into independent entities. They are given more financial and organisational autonomy, but they remain as they were in regards to personnel. Additionally, they are asked to devise and obliged to meet a performance agreement. Thus FLAG offices are known as *partially* corporatised entities. Given the recency of the program, little evidence exists as to its success.

30. An additional element of the Swiss reform experience is the power of, and consequent need to include, unions in reform efforts. Especially where employment conditions might change for employees of privatised or corporatised entities, negotiations must include union representatives and their needs must be addressed. While other governments must be similarly aware of this factor, the political and economic ramifications of unsuccessful reform efforts in Switzerland have been very severe, and have aided in changing reform strategies to insure the receipt of input from all concerned parties.

United Kingdom

31. The first major privatisations, and the first important successes of the policy, were witnessed in the United Kingdom. Originating from a Conservative Party report, the privatisation “solution” to British fiscal problems has grown into a multi-billion pound policy that has been embraced by both major political parties and a vast majority of the citizenry. Indeed, the policy’s success, and its wide-ranging support, have led to the dissolution of almost all state enterprises, except for the Post Office, which remains the only sizeable state-owned enterprise.

32. Prior to the commencement of reforms in the early 1980s, the British government was amongst the more interventionist of OECD Member countries. It owned both competitive and monopolistic enterprises, including British Airways, British Steel and the utilities. In 1979, just before reforms were instituted, the state-owned enterprises were responsible for 10 percent of GDP, a seventh of all investment in the country and about one-tenth of the composition of the Retail Prices Index.

33. The financial conditions facing the United Kingdom in the late 1970s, and the lagging fortunes of many state enterprises, combined to push forward the first, limited and tentative, privatisation experiments. Once they proved successful, and the policy gained further backing, reforms began to pick up speed. Although Britain was the early leader in reform efforts, its policies have developed very little since the start of the 1980s. In particular, policy makers have predominately used the privatisation strategy, with few, if any, examples of corporatisation present.

34. While privatisation has been the favoured policy, the public flotation of enterprises has been the preferred method for transferring ownership. Although some large firms, including parts of British Steel and British Rail were transferred by private sale, and the National Freight Corporation, uniquely, was directly sold to its employees, most large state enterprises have been sold through flotation.

35. Indeed, financially, privatisation has been a very lucrative business for the government, garnering it at least one billion pounds every year since 1983, and often many multiples of that. Although the accounting practices employed to value the sales have accentuated the official financial impact of privatisation, it is clear that the policy has been financially successful for the government. More importantly, there is mounting evidence that privatisation has been profitable for the now private firms. Privatised firms, on the whole, have not only performed better than when they were government-owned, but have often done so in the face of very unfavourable economic conditions.

36. There are two other parts of privatisation's success in the United Kingdom. First, along with increased economic performance, service has also been enhanced through privatisation. This is partly due to hardy regulatory regimes for monopoly enterprises that control service and cost, but in the competitive industries, competition itself is the likely motivator for improved service. Additionally, the government had a goal of forming a nation of citizen investors. To that end, in many privatisations, the government favoured individual British investors, at the expense of institutions and foreign buyers. The percentage of Britons who now own shares is 22 percent, a 15 percentage point jump from the number of citizens who owned stock in 1981.

37. Despite its overall success, there are important concerns that have arisen in the wake of privatisations. This refers especially to the maze of regulations which have been erected for privatised industries in monopoly markets. While the goals of the regulations are laudable, it is unclear how "privatised" these entities really are, so long as the government controls so many of their functions. Additionally, it has been difficult for many firms to respond effectively to market conditions because they are hampered by regulatory measures.

38. Yet, despite these problems, and growing public disenchantment with some privatised enterprises (notably in regard to price rises in the water industry), privatisation has been a resounding success for the United Kingdom, and the British experience has in several ways shaped the reform strategies of countries throughout the OECD.