Selling State Assets: Three Options

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Under the EU/IMF Programme for Financial Support for Ireland, the government undertook to consider the potential for disposing of State assets. In the 2011 Programme for Government a target of up to €2 billion was set for the sale of non-strategic State assets, but only after adequate regulatory structures to protect consumers were in place. The State owns important parts of the economy – including the ports, airports, electricity generators, and transmission systems (gas and electricity). It also owns a household waste collector, a tour operator, a horticulture business, and a stud farm. The sale of State assets is nothing new – €8.3 billion has already been raised through the sale of State assets in steel, sugar refining, banks, telecommunication and airlines. Largely as a result, the share of the commercial state sector in total employment fell from 8 per cent of total employment in 1980 to 2 per cent in 2008.

Three Options for Deciding Which State Assets to Sell

Perhaps the most obvious rule for selling State assets is ***to sell the most valuable assets.*** One could sell the largest companies until the cumulative total of €2 billion had been reached. However, this would leave the largest number of State assets in state hands and fails to distinguish between strategic and non-strategic assets. Monopolies would be sold intact, thus leading to higher prices for consumers and businesses. Although State assets are frequently located in the non-traded sector, their goods and services are used as inputs by other sectors, so these higher prices are likely to damage the export sector. Regulation can, of course, be introduced to combat the exercise of market power, but the regulator would face considerable difficulties dealing with a monopoly, particularly if it is vertically integrated with activities in non-related fields.

A second rule would be to sell ***a minority share***. This option has been selected by the State in the case of ESB. Again assets would be valued and when the cumulative total of €2 billion was reached the exercise would be concluded. This approach has the advantages that the distinction between strategic assets and

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non-strategic does not have to be made since the government retains control, and it is a lower risk strategy for price discovery at a time when the market may undervalue Irish assets. However, it has certain important drawbacks. Arguably the result is a dysfunctional governance structure. Three groups with sometimes sharply differing objectives would constitute the board: the Employee Share Ownership Plan, the State and the private investor. Selling a minority share makes it much more difficult to change the structure of the new firm. A minority shareholder would not be able to restructure and reorganise the State-owned firm so as to realise efficiencies and improve profitability. As a result a bidder for a minority stake is unlikely to bid a high price.

The third rule is the ***economic approach using a market failure framework***. This approach assumes that in general private ownership and market forces are the best way of organising economic activity. However, in some instances markets fail and government may have a role in correcting the failure. Using this approach four sets of questions are raised:

- What is the rationale for State ownership – to curb market power, to capture externalities or to provide public goods?
- Is the rationale still relevant – conditions such as technology, market size, and/or financial instruments may have changed?
- Are there better, more cost effective policy instruments – a tax, public private partnerships, tendering – that could be used to attain the objectives?
- What objectives are best met through public ownership – natural monopolies such as energy transmission systems, especially if adequate regulatory safeguards and sanctions cannot be put in place?

This approach is consistent with that used in the report of the Review Group on State Assets and Liabilities. The use of this approach can be illustrated with respect to Bord na Mona, which was founded in 1946. Given the reliance of Ireland on imported oil, coal and gas for electricity generation, the availability of a domestic fuel, peat, provided some security of supply. However, it is not clear that this rationale is still relevant to-day. CO_2 emissions from peat are high, while consumer electricity bills in 2011 were increased by €78 million to support peat burning generators. Ireland already has high electricity prices compared to other EU Member States. Security of supply is now being improved through electricity interconnection with Great Britain, while gas will soon be available from the Corrib field. All this suggests that there are no strong grounds for Bord na Mona peat mining activities to remain in public ownership.

If the aim is to raise €2 billion from privatizations, then, under the economic approach, one would first sell those companies that do poorly under the current, public ownership but which a private owner believes can be made profitable. This would balance the sale value of the State assets against the stream of dividends from the companies that remain in State ownership.

Which Option?

Ireland has few policy levers with which to generate growth and employment, with monetary policy controlled by the ECB and fiscal austerity limiting the role of fiscal policy. Micro-economic reform is one of the few policy levers left. State assets are present in some of the most important sectors of the economy. By creating the right incentives for efficiency, prices in these largely non-traded sectors can be lowered, thus assisting in raising Ireland's competitiveness. The economic approach outlined has the best chance of meeting this test. Strategic assets are identified, and retained in public ownership. Dysfunctional governance structures are identified and remediated.

What Assets?

The Programme for Government foresees the sale of companies that are owned by the State. There are other assets too. Some (quasi-)government agencies engage in commercial activities, such as R&D and sales promotion. The government owns three television channels and four radio stations. Improvements to government finances from privatising such assets would arise primarily from reduced subsidies rather than amounts raised by the sales. The government also owns the radio spectrum and issues permits to exploit oil and wind and emit carbon dioxide. The government should also seek to maximise the value of these assets, perhaps through dividends in public ownership, perhaps through incorporation and sale.

Economic circumstances have put privatisation on the political agenda. This opportunity should be used to strengthen market regulation as the government focuses on its core tasks.

P.K. Gorecki, S. Lyons, R.S.J. Tol, 2011. "Public policy towards the sale of state assets in troubled times: Lessons from the Irish experience", *Utilities Policy*, Vol. 19, pp. 193-201.