

AN ECONOMIC ANALYSIS OF PRIVITISATION IN IRELAND, 1991-2003

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Abstract: Although a late starter with regard to privatising State Owned Enterprises (SOEs), Ireland was recently ranked 8th among OECD countries in terms of relative privatisation activity. This paper presents the first detailed analysis of the programme since the first divestiture in 1991. It explores how the rationale for selling SOEs has evolved and argues that privatisation has been pursued on the basis of multiple (sometimes conflicting) objectives. One goal that has been common to all divestitures has been that of improving company performance. Although we find evidence that SOEs achieve 'static' efficiency gains in the pre-privatisation period, the available evidence fails to support the hypothesis that privatisation brings about sustained improvements in enterprise performance. Privatisation has also been pursued in order to raise exchequer revenues and achieve certain distributional goals. Although the levels of share discounts and expenses have been low by international standards the government has foregone significant revenues by granting sizeable share ownerships to workers. Consequently workers along with institutional investors rank among the 'winners' from privatisation whereas small shareholders (in the case of Eircom) and the exchequer have incurred significant losses. Importantly, there is little to suggest that privatisation *per se* has yielded significant gains to the consumer. This raises questions about the sequencing of measures of privatisation and liberalisation.

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1. INTRODUCTION

Over the last twenty years, the privatisation of state-owned enterprises (SOEs) has become an important instrument of industrial re-organisation. The OECD (2003) estimates that over the past two decades more than 100 countries worldwide have adopted privatisation policies. Privatisation, as well as measures of de-regulation, has had major consequences for the ownership and structure of major industries around the world. In global terms, Ireland has been a relative latecomer with regard to adopting privatisation policies but in recent years a number of SOEs have been transferred to private ownership. When considered in connection with the liberalisation of markets such as energy, telecommunications and public transport, privatisation has had a marked impact on the composition of the Irish public enterprise sector as well as the structure of important markets. It has also had significant effects in terms of corporate performance, employment and equity markets.

This study examines Ireland's programme of privatisation. It focuses on the sale of SOEs rather than other forms of privatisation such as contracting-out and public private partnerships. It details the privatisation programme to date and briefly examines the rationale for selling SOEs in the Irish context. It proceeds to examine the effects of privatisation in terms of corporate performance, public finances and the distributional aspects of privatisation including the impact on employment and share ownership.

2. REASONS FOR AND EXTENT OF PRIVATISATION WORLDWIDE

Privatisation has been a truly global phenomenon. Different regions and countries around the world have embraced privatisation to different degrees with the result that the role of SOEs has declined considerably. Megginson *et al* (2001) show that the share of GDP accounted for by SOEs in industrialised countries fell from 8.5 per cent in 1984 to less than 6 per cent in 1991 and is now below 5 per cent. For low-income countries the reduction has been more dramatic with a reduction from almost 16 per cent of GDP to below 5 per cent. Similar reductions were recorded in middle-income countries (which include the transition economies in Central and Eastern Europe).

Among industrialised countries the UK and New Zealand were the first real pioneers of privatisation.¹ Parker (1998), in a review of the privatisation experience in the EU, found that the UK leads the rest of Europe in terms of the value of assets sold and the extent to which it has adopted other forms of privatisation. He also notes that in recent years however, privatisation activity has intensified in other member states of the EU such as Spain, Portugal and Greece.

The growing popularity of privatisation programmes can be attributed to a host of reasons with the precise rationale varying from country to country. Writers such as Kay and Thompson (1986), Parker (1998), and the OECD (2003) have explored these reasons and with regard to industrialised countries the following arguments dominate: (1) that SOEs are inefficient and that privatisation will lead to improved economic efficiency; (2) that technological developments in markets such as telecommunications and electricity generation have rendered monopoly provision of certain goods and services obsolete. This has been an important factor in driving the liberalisation agenda set by the EU; (3) that selling SOEs can contribute to reducing government debt and remove the risk of future capital injections into loss-making SOEs and; (4) that the divestiture of SOEs can make useful contributions to developing domestic capital markets.

2.1 Improving Efficiency

The fundamental economic case for privatising SOEs is that the change in ownership leads to improved enterprise performance. This conclusion is drawn from theories of government failure such as agency, public choice and property rights theories. In general the relative inefficiency arising from public ownership is attributed to continuing political involvement in their management, soft budget constraints and the absence of competition (Stiglitz, 1991). Transferring enterprises to the private sector and the introduction of competitive product markets can bring about changes in organisational structure, alter owner and manager objectives and improve monitoring, information and incentive structures (Bös, 1991). The expectation is that these changes will lead to improvements in operating efficiency.

Prior to the mid-1990s, empirical studies on the performance of public enterprise focused on comparisons between public versus private sector enterprises rather than the impact of privatisation *per se*. Comparative studies have been reviewed by a number of writers (e.g. Boardman and Vining (1989), Borcharding *et al* (1982), Vickers and Yarrow (1988), Bös (1991), Martin and Parker (1997)). Conclusions vary from study to study and overall they fail to provide clear-cut evidence of the superiority of either type of ownership. Moreover the studies vary in terms of aspects such as timing, sectors covered and performance measures used. Martin and

¹ Stevens (1992) found that New Zealand and the UK had implemented the biggest privatisation programmes. Revenues from sales in New Zealand accounted for 14.1 per cent of GDP over the period 1987-91. The equivalent figure for the UK (1979-91) was 11.9 per cent.

Parker (1997) conclude that the evidence does point to superior profitability in private enterprises but caution that profit is not necessarily an appropriate measure especially where markets are not competitive. High profits may be due to over-charging consumers rather than from reducing costs of production. Where studies focus on cost and productivity measures, the proposition that SOEs are relatively inefficient is more likely to be supported where firms operate in a competitive environment. “Where monopoly conditions exist, particularly in water supply and in gas and electricity transmission and distribution, state regulation may dull efficiency incentives in the private sector” (Martin and Parker, 1997: 76).

Since the mid-1990s a host of studies covering the impact of privatisation on enterprise performance have been published. Megginson and Netter (2001) surveyed empirical studies on the performance effects of privatisation in transition and non-transition countries. Almost all of these studies examine the impact of privatisation in terms of output, efficiency, profitability, capital investment and leverage. They conclude that the 22 studies of privatisation in non-transition economies “offer at least limited support for the proposition that privatization is associated with improvements in the operating and financial performance of divested firms. Several of the studies offer strong support for this proposition and only Martin and Parker (1995) document outright performance declines (for six of eleven British firms) after privatisation” (2001: 356).

It is noteworthy that the exception to these findings was a study by Martin and Parker (1995). These writers, in conjunction with others, have published a number of reviews and studies on privatisation and performance in the UK. Martin and Parker (1997) conducted an in-depth study of eleven companies privatised in the UK since 1979. Performance was examined in terms of a host of financial and productivity measures while controlling for business-cycle effects. Taking all eleven companies together they conclude that there is little evidence of a systematic improvement in performance and, notwithstanding problems with performance measurement, they arrive at this conclusion using a range of measures (1997: 216). They also conclude that the relationship between ownership, competition, regulation and performance is more complex than they would ever have imagined.

Focusing on the relationship between these issues in the context of utility industries, Parker (2003) publishes a more recent review of studies from the UK and finds that a number of studies were “unable to reject the null hypothesis that ownership has no effect on performance” (2003: 85). In a number of cases performance improvements recorded continue a trend that pre-dates privatisation.

One explanation for mixed results is as follows:

“The greatest scope for efficiency gains occurs in utility industries where previously monopoly suppliers existed. Where state industries operate in competitive markets there is less scope for management to make large efficiency gains after privatisation. Presumably enterprises must have already been reasonably efficient to have survived in competitive markets, at least in the absence of continued state subsidies. Competition and regulation are important in providing the necessary incentives for management to seek out efficiency gains following privatisation. Therefore until competition and regulation significantly impact efficiency gains will be limited” (2003: 78).

2.2 Privatisation as a Response to Competition and Technological Developments

Technological developments and their interaction with the liberalisation of markets (in the EU driven by common EU directives) have provided a basis for privatisation in certain sectors previously characterised by state ownership. This has been particularly evident in the case of telecommunications. The continuing digitalisation of electronic communications and services has resulted in a convergence, which sees a range of networks and industries that traditionally operated independently of each other now finding themselves either competing directly or relying on each other (Massey and Daly, 2002). These developments have undermined traditional arguments in favour of public ownership (for example natural monopoly arguments) and in the EU the response has been to apply pressure on member states to open utility markets to competition. Telecommunications markets in all EU member states were gradually de-regulated prior to full liberalisation, which came into effect on January 1st 1998.¹

In sectors such as gas, electricity and telecommunications, privatisation has been used as a vehicle to enhance competition by providing an opportunity for sector restructuring where governments replace state-owned monopolies with several competing firms and, in the case of network industries, establish third party access and competition rules. Privatisation measures have also been adopted in response to the enforcement of EU competition laws restricting state aids to public enterprises. Article 92 of the Treaty of Rome forbids state aid that distorts competition between member countries. Although the European Commission has not always been successful in preventing governments from supporting loss-making industries (Parker, 1998) there have been cases where governments have advanced these restrictions as a justification for divestiture (for example, Irish Steel).

2.3 Raising Exchequer Revenues and Improving Public Finances

Most governments view privatisation as a means of improving public finances. In the UK for instance, the Thatcher governments used accounting conventions to deduct the proceeds of privatisation from the public sector borrowing requirement (PSBR). This essentially amounted to a sleight of hand in the accounting sense as privatisation proceeds are financing government expenditure and should therefore be added to the PSBR. This was recognised by the EU commission, which disallowed privatisation receipts in the calculation of budget deficits under the Maastricht criteria. Nevertheless, privatisation receipts can be used to reduce government debt, which will indirectly reduce budget deficits via lower interest payments.

From an economic perspective the key question is how does privatisation affect the net worth of the public sector? Vickers and Yarrow (1988: 185-188) describe how it is necessary to distinguish between the short-term and long-term effects of privatisation on government accounts in order to determine its real economic position. In the short-term, the net effect depends on how much the exchequer borrowing requirement (EBR) is reduced by the sales proceeds, the company's payment of interest and dividends and the capital expenditure programme of the company. However, if the company is profitable (which is a realistic assumption) its profits move out of the public sector accounts thereby increasing the EBR.

In the long-term, the financial impact depends on whether the assets are correctly priced and on

¹ Ireland was granted a partial derogation from the provisions of the final directive, which removed final restraints on competition in telecommunications markets. Full liberalisation took effect in December 1998.

the issue of transaction costs (e.g. promotion and professional fees). In essence, an asset is correctly priced if the sale price equals the discounted value of all future income streams to the government. If the government receives this price and does not incur any transaction costs, its net worth does not change. Neither of these circumstances is likely to occur, however. The situation becomes more complicated when one takes the impact of privatisation on company behaviour into account. If the company improves its performance after privatisation and this is accounted for in the price, then the net worth of the government depends on the direct and indirect costs incurred in the process of privatisation. Indirect costs arise due to underpricing of shares or the allocation of shares at preferential rates to employees. Direct costs include promotion, advisory, financial, legal and accountancy fees.

On the question of indirect costs, most authors agree that the extent of undervaluation varies according to the method of sale and to the various underlying political and economic objectives of privatising governments. Some see discounting shares as a 'cost' that governments should avoid in order to maximise the returns accruing to the Exchequer. For example, Vickers and Yarrow (1988) and Jenkinson and Mayer (1994) claim that the extent of underpricing observed in the U.K. was due to the 'flawed' methods of sale chosen by the government and argue that selling a company's equity in several tranches is superior to selling all the shares at once. Nevertheless, there are many reasons why governments may choose to issue new equities at a discount. These include the requirement to entice small shareholders to purchase new shares and to avoid possible embarrassment if shares are unsold.

Estimates of the cost of underpricing indicate that they involve significant revenues foregone by governments. For example, Jenkinson and Mayer (1994) estimate 'avoidable discounts' based on the typical discounts observed in similar private-sector issues. They estimated that the cost of underpricing in the case of UK privatisations amounted to approximately £2.5bn between 1979 and 1991, or nearly 8 per cent of proceeds. In their analysis of the French privatisation programme, the authors also find that if the normal discount for the sale of a company was taken to be 5 per cent, the revenue forgone by the French government between 1986 and 1987 amounted to some €1.2 billion, or nearly 10 per cent of proceeds.

In relation to direct costs, the magnitude of privatisation expenses incurred in the early UK privatisations attracted much criticism with expenses in the case of British Gas for example, amounting to £360 million. Wright and Thompson (1994) note that concerns over the size of these expenses resulted in closer attention being paid to project management in subsequent flotations. They estimate that expenses averaged 6.4 per cent of gross proceeds in the UK before 1990 and that these were reduced on average to between 2.4 and 2.8 per cent for later sales (Wright and Thompson (1994: 60). The comparable estimate in the case of Australian sales was just over 3 per cent (Harris and Lye, 2001).

Despite the significance of these direct and indirect costs it is evident that raising exchequer revenues is an attractive feature of privatisation for governments. Consequently, Parker (1999) notes that it is commonplace for governments in the EU to announce targets for annual sales as part of their budget forecasts and countries such as France, Italy and Portugal have passed legislation to limit the use to which privatisation receipts can be put.

2.4 Capital Market Development

For many OECD countries the need for well-developed equity markets as a means of channelling investment and the need to strengthen the institutional investor presence in domestic equity markets underscores capital market development as an explicit objective of privatisation (OECD,

2003:24). In some countries (for example, Spain, Portugal and Austria) privatisation was used as a means of developing capital markets whereas in others (for example, the UK and to a lesser degree France and Germany) privatisation served to augment what was already there.

More specifically, privatisation has been used as a means of achieving the capital market objective of broadening share ownership and attracting small investors to buy shares. In the UK, the Conservative government emphasised this objective. However, it is unclear whether this objective has been achieved. The early indications from the UK were that share ownership had widened but not deepened, with small shareholders investing in very few companies and often investing for short-term speculative gains.² In Germany roughly one-half of the two million citizens who bought shares in Deutsche Telecom in 1996 sold their shares within a year (Parker, 1999).

The following sections examine the Irish privatisation experience. First we detail the extent of privatisation in Ireland to date and seek to identify the rationale for various sales. We proceed to examine the experience to date in terms of enterprise performance, government finances and key distributional aspects of privatisation to date.

3. PRIVATISATION POLICY IN IRELAND TO DATE

Prior to 1991 there were few examples of privatisation in Ireland. It is noteworthy that the privatisation option was largely eschewed throughout the 1980s despite a growing fiscal crisis and the obvious attraction of privatisation revenues.³ In some cases enterprises were retained under public ownership in order to serve political and social objectives such as maintaining employment and fostering regional development.⁴ Moreover, the first social partnership agreement – the *Programme for National Recovery* – enunciated policies that aimed to expand rather than privatise the SOE sector.⁵

The early 1990s however, witnessed a gradual shift in policy concerning the ownership of SOEs. This coincided with a significant change in the political context with the pro-privatisation Progressive Democrats (PDs) entering government for the first time as the minor party in the new coalition formed in 1989. The second social partnership agreement – the *Programme for Economic and Social Progress* – which was signed in 1991 set out a number of principles in relation to SOEs including agreed principles on the questions of private involvement in the shape of joint ventures and the sale of shares.⁶ These developments coincided with the decisions to privatise two SOEs, Irish Sugar Company (now Greencore) and the state-owned insurance company, Irish Life Assurance, by initial public offering (IPO) in 1991.

These divestitures failed to serve as harbingers of a systematic programme of privatisation. Besides the sales of two ailing companies as going concerns (B&I in 1992; and Irish Steel in 1995) there was no significant privatisation activity until the flotation of shares in Eircom in July 1999. This sale represented the first high-profile privatisation in the case of Ireland. Over

² A survey by the Confederation of British Industry in 1990 estimated that, of 10.6 million individual shareholders, only 14 per cent owned shares in four or more companies, while no fewer than 61 per cent owned shares in only one (quoted in Saunders and Harris, 1994: 144)

³ Ireland's public finances deteriorated considerably in the 1980s. By 1986, the ratio of debt to GNP had reached an unsustainable 129 per cent.

⁴ Sweeney (1990:47) asserts that in the 1970s and 1980s there were "open cases of government directives to companies to keep plants open which management considered to be unviable such as Irish Sugar's Tuam plant and several ESB stations".

⁵ Allen (2000: 14) asserts that when the Programme for National Recovery was agreed in 1987, the Taoiseach, Charles Haughey, promised the trade unions that Fianna Fáil would not sell off any commercial SOEs.

⁶ Programme for Economic and Social Progress (1991: p.59)

500,000 citizens purchased shares in the newly privatised utility following an exchequer funded advertising campaign specifically focused on small investors. The initial consensus was that the sale was a success and that all remaining public enterprises were candidates for transfer to private ownership. This consensus was short-lived however due to the collapse of the Eircom share price and subsequent break up of the company.⁷

Notwithstanding the controversy surrounding the sale of Eircom, four SOEs have subsequently been privatised. In 2001, three state-owned banks, which had been earmarked for privatisation since the early 1990s, were taken over by private institutions and the Irish National Petroleum Company (INPC) was sold to the US oil company Tosco.

Overall, privatisation has had an appreciable impact on the Irish economy. The data in table 1 shows that total government proceeds from privatisation have amounted to €8.13bn. When measured as a percentage of national income, privatisation proceeds in Ireland are sizeable by OECD standards. Measuring privatisation proceeds relative to the size of the economy, the OECD (2003) ranked Ireland eighth out of 29 OECD countries over the period 1990-2001.

Table 1: Privatisation of Irish State-Owned Enterprises 1991-2002

Company	Year	Sector	Exchequer Proceeds (€m)	Method of Sale
Greencore	IPO in April 1991	Sugar/Food	210.65	IPO and Placements
Irish Life	IPO in July 1991	Insurance	601.93	IPO and Placements
B&I	1992	Shipping	10.80	Trade Sale
Irish Steel	1994	Steel	0	Trade sale
Eircom	IPO in July 1999	Telecommunications	6,399.91	Trade sale and IPO
ICC Bank	Jan 2001	Banking	322.27	Trade Sale
TSB Bank	April 2001	Banking	408.35	Trade Sale
INPC	May 2001	Energy	20.00	Trade Sale
ACC Bank	December 2001	Banking	154.60	Trade Sale
Total			€8,128.51	

Notes: (1) This excludes the sale of Cablelink to NTL. In this case the sale proceeds were accrued to Telecom Éireann (Now Eircom). (2) IPO – Initial Public Offering (3) In the case of Irish Life, Greencore and Eircom, companies were privatised in stages. The dates provided refer to the dates of the IPO.

⁷ Eircom was taken over by the Valentia Telecommunications Consortium. When Eircom was de-listed from the Irish Stock Exchange in December 2001, the 450,000 small shareholders who retained their shareholding in Eircom had incurred a 30 per cent loss.

In addition, privatisation has had a significant impact on the composition of companies in the SOE sector, with the State no longer directly involved in the telecommunications, banking or food sectors. Table 2 lists the remaining eleven Irish SOEs as of mid-2004. In most cases the State retains ownership in companies that hold dominant or monopolistic market positions. In recent years government policy on remaining SOEs has been characterised by the introduction of competition and the consideration of the privatisation option. Aer Lingus, the state-owned airline, is expected to be part privatised. Competition has been introduced in the electricity, health insurance and broadcasting sectors and the state-owned airports company (Aer Rianta) and transport company (CIE) are being broken up and subjected to competition. Since the mid-1990s most SOEs have been instructed to examine alternative ownership structures (for example, strategic alliances). In addition, a new regulatory framework has been developed with the establishment of independent regulators in sectors such as energy, communications and aviation and the establishment of the Competition Authority in 1991.

Table 2: Commercial State-Owned Enterprises in Ireland 2004

Company and Sector	Established	Principal Activity	Market Power in Principal Activity
<u>Finance</u>			
Voluntary Health Insurance	1957	Health Insurance	Duopoly
<u>Communications</u>			
An Post	1984	Postal Services	Monopoly
Radio Teilifís Éireann	1960	Broadcasting	Competing
<u>Energy</u>			
Bord Gáis Éireann	1976	Gas Distribution	Monopoly
Bord na Móna	1946	Peat Production	Competes
Electricity Supply Board	1927	Electricity	Limited Competition
<u>Natural Resources</u>			
Arramara Teo	1949	Seaweed Processing	-
Coillte Teo	1989	Forestry	Dominant
<u>Transport</u>			
Aer Lingus	1936	Air Transport	Competes
Aer Rianta	1937	Airports	Dominant
Coras Iompair Éireann	1944	Rail and Road Transport	Dominant

One of the interesting questions that arise in connection with Ireland's privatisation programme concerns government objectives in relation to different divestitures. This question is commonly addressed in studies of privatisation in other countries and comparative studies show that the motivation for privatisation programmes varies across jurisdictions. For example, the privatisation programme in the United Kingdom, which dates back to the late 1970s, was driven by a dominant

pro-market discourse that argued for privatisation on the grounds that it promised improvements in economic efficiency. However, in his comparative study of privatisation in the EU, Parker (1998) notes that this argument struck a chord in some but not all member states. Instead he finds that “privatisation in the EU results from forces including the ‘fashion’ to privatise evident worldwide but more pragmatically, expediency” (1998: 2). Ireland represents an example of the latter with the privatisation programme to date based on pragmatism rather than attachment to a particular ideology. Consequently the executions of individual sales have been based on a mixed set of reasons that vary across cases. Evidence of the multiplicity of objectives attributed to privatisation is illustrated in the case of Irish Sugar/Greencore (and they apply equally to the case of Irish Life which was also privatised in 1991).

For a number of years, the Chairman and Chief Executive of Irish Sugar made the case for privatisation on the basis that injections of capital were necessary if the company was to expand, diversify and improve performance. As the government was reluctant to sanction further capital injections, the principal rationale for privatisation was that it offered the best means of widening the company’s equity base which was necessary to ensure further improvements in company performance. There is however, evidence that privatisation was being driven by additional considerations. In his budget speech in 1990 the Minister for Finance, Mr. Albert Reynolds, highlighted the importance of exchequer based considerations when he

“...made a prudent provision in the White Paper on Receipts and Expenditure for a further increase in sales [of state assets] in the current year. This is the first phase of a new five-year programme of such sales so as to reduce the national debt.”
(Budget Book, 1990:34).

There was also evidence that at the outset, privatisation policy was partly based on the desire to attract small shareholders. In the case of Greencore, special provisions were made for the allocation of shares to employees and beet growers, while the initial public offering was weighted in favour of small investors with small applications (below 140 shares) met in full and larger applications scaled back.

Discerning the objectives of privatisation in the cases of the two divestitures that followed (B&I Line and the Irish Steel Company in 1992 and 1996 respectively) is relatively straightforward. Both companies were in serious financial difficulty before privatisation and the decisions to sell were demonstrably attributable to the desire to remove loss-making companies from the State balance sheet.

By the mid-1990s, Ireland’s increased integration within the European Union brought a new set of factors, which had a significant bearing on public enterprise policy in Ireland. The central thrust of EU policy has been the removal of restraints on trade resulting from regulation and while official EU policy reflects a neutral stance on ownership of industry, the effective impact of policy has been to encourage privatisation. Examples of relevant policy include:

- The Maastricht criteria for eligibility to join the single European currency, which made the sale of SOEs attractive as proceeds could be used to retire public debt;
- Restrictions on state aids to industry under Article 92 of the Treaty of Rome and;
- The requirement for liberalisation of utility markets.

The latter factor in particular influenced the decision to privatise Telecom Éireann, the state-owned telecommunications company. Although finally sold in 1999, the privatisation process could be traced back to 1991 when the company chairman called for privatisation as a response to the challenges posed by increased competition and technological change. This precise rationale

underpinned subsequent decisions in relation to ownership of the company. In 1996 the decision was taken to enter a strategic alliance with an established player in the European telecommunications market. This involved the sale of 20 per cent of Telecom Éireann's share capital to the *Comsource* consortium consisting of PTT Telecom BV and Telia AB.⁸ With the Progressive Democrats back in government following the 1997 General Election the drive towards privatisation was accelerated. Shortly before the full liberalisation of the telecommunications market came into effect in December 1998, the Government announced its intention to dispose of its remaining shareholding in the company. The initial public offering of Telecom shares took place in July 1999.

The three state-owned banks (ICC, ACC and the Trustee Savings Banks) commanded small market shares of the Irish banking markets. Historically the ICC and ACC were heavily subsidised by the State (Sweeney, 1990a) and their future (and possible privatisation) had been under consideration since the early 1990s. The decision to privatise was attributable to the desire to eliminate state involvement in the banking sector. When outlining the history of the proposed sale of the ICC bank, the Minister asserted that the Government decided to "dispose of the State's interest in ICC Bank plc as there is no longer any significant strategic or policy justification for continuing direct state involvement in the banking sector".⁹

The rationale for the sale of the Irish National Petroleum Company (INPC) in 2001 was based on the opportunity to de-regulate the company's operations. The company relied on a mandatory regime whereby private oil distributors were required to source 35 per cent of their sales from the INPC. When presenting the Bill to privatise the company, the Minister stated that the mandatory regime "was a poor substitute for a proper commercial environment for the Company within the mainstream oil industry".¹⁰ Concern was expressed that dependence on the mandatory regime was likely to increase, as large-scale investment was required to meet new emission standards for motor fuels. On the basis of these considerations the Government sought a buyer for the company.

In conclusion, it is evident that Ireland's privatisation programme to date has been based on a policy driven by pragmatism with decisions made on a case-by-case basis. Although reasons such as restrictions on further public investment have been advanced to justify some cases, a common rationale has been that privatisation will improve company performance. The evidence also demonstrates the perceived merits of privatisation as a useful means of raising revenues for the exchequer. The potential impact of privatisation on various stakeholders has also shaped decisions in relation to privatisation policy. Concerns about job losses had been an important consideration in SOE policy and in recent years more favourable labour market conditions have eased the passage of SOEs to the private sector. Moreover, since the sale of Eircom, the norm has been to establish Employee Share Ownership Programmes (ESOPs) amounting to 14.9 per cent of shares in newly privatised companies. With small shareholders also encouraged to participate in sales by initial public offering it is evident that privatisation policy has been directed towards the achievement of certain distributional objectives. The following sections examine the Irish privatisation experience in terms of these discernible objectives.

⁸ PTT Telecom became Royal KPN NV in 1998 and was the national telecommunications company of the Netherlands prior to the liberalisation of EU telecommunications markets in 1999. Telia AB was the Swedish national telecommunications company prior to the same date.

⁹ Minister of State at Dept. of Trade, Enterprise & Employment, Mr. Noel Treacy, Dáil Éireann Debates Dec. 8th, 1999.

¹⁰ Minister for Public Enterprise, Mrs. Mary O'Rourke, Dáil Éireann Debates June 20th, 2001.

4. PRIVATISATION AND ENTERPRISE PERFORMANCE

Of the different reasons advanced in support of privatisation policy, the goal of improving the efficiency of former SOEs has been most prominent. Studies of performance most commonly adopt measures of profitability, productivity and costs of production. Profitability measures are however, unsuitable where enterprises operate in imperfectly competitive markets, which is the case for most SOEs. Consequently, productivity measures are preferred but these are also subject to limitations. Labour productivity measures can be biased for reasons such as the use of output rather than value-added as a numerator and the prevalence of contracting out labour intensive services. Total factory productivity measures face reliability problems due to difficulties in measuring capital accurately (Parker, 2003).

Besides the difficulties inherent in performance measurement our study of the performance of privatised companies in Ireland is conditioned by the following factors:

- the number of companies is relatively small with nine companies privatised to date;
- six of the nine privatised companies were sold by trade sale and absorbed into the operations of the acquiring company. As a result post-privatisation data is available for three companies only. Moreover, Eircom was privatised in 1999 thereby limiting the post-privatisation period;
- with the exception of Eircom, privatised companies operate under competitive conditions;
- four of the companies operate in the financial sector and analysis of the Irish Life Assurance Company in particular requires sector-specific measures.

Bearing these factors in mind this analysis of the performance of privatised companies examines the pre- and post-privatisation periods separately.

4.1 Pre-Privatisation Performance

Firms that have been privatised to date differ significantly in terms of size, sector and performance history. The first two sales in 1991 were of relatively successful commercial entities. These were followed by the sales of two firms which were in serious financial difficulty. In 1999 the State disposed of its first utility company while the next disposals were of the three state-owned banks and the INPC¹¹ which all had different performance records.

Looking first at the loss-making companies, the British and Irish Steam Packet Company (B&I) facing increased competition from the airline sector, entered the 1990s in severe financial difficulty. At the end of 1989 the company had accumulated losses of €163m and a capital deficiency of €33.6m (Barrett, 1998). As a small stand alone company in a much bigger European and global market, the Irish Steel Company was in financial difficulty since the early 1970s. It received more capital than any other state company and recorded losses of over twice its turnover in the early 1980s (Sweeney, 1990).¹² Table 3 shows indicators of the average annual rates of change in performance in the five-year period prior to privatisation. Despite conducting

¹¹ The INPC is not included in our analysis. The volatility of the global oil market within which the company operated distorts profit-based indicators, which were subject to wide fluctuations in the years preceding privatisation. Consequently rates of growth measures are not instructive.

¹² Irish Steel received capital of approximately €235m over the period 1980-1993.

significant programmes of rationalisation¹³ in the years prior to divestiture both companies continued to perform poorly and in both cases the decision to privatise was justified as the only means of ensuring that the companies continued as going concerns.

Table 3: Pre-Privatisation Performance of loss-making SOEs
- Average Annual Rates of Growth

Company	Employment %	Turnover %	Sales Efficiency %	PBIT %	ROCE %
Irish Steel	-1.76	-2.75	-1.42	-135.15	-183.32
B&I	-14.59	-11.28	4.85	-63.92	-124.15

Notes: (1) Sales Efficiency = Turnover/Employees; PBIT = Operating profit before interest, tax and exceptional items; ROCE = PBIT / Net Assets Employed. (2) Irish Steel rate of growth is a five year average. B&I rate of growth figure is a four year average.

Up to the late 1980s, the Agricultural and Industrial Credit Corporations (ACC and ICC) were poor performers in financial terms. Established to provide credit for farmers and the industrial sector, both banks focused on serving niche markets and lacked the scale necessary for expanding their share of the Irish banking market. Moreover they relied heavily on the State for subsidies in the form of guarantees on foreign exchange borrowings (Sweeney, 1990).¹⁴ Aided by the rapid growth of the Irish economy in the 1990s, both the ACC and ICC banks and the Trustee Savings Banks (TSB) significantly improved financial performance in terms of income and profitability. Table 4 shows the average annual growth rates for a number of indicators over the five-year period prior to privatisation. Average growth in profits before interest and tax (PBIT) ranged from 8.25 to 22.45 per cent in the period covered. The more instructive return on assets (ROA) and cost-income ratios however indicate that underlying performance was less impressive for both the TSB and ACC. In 2001 these banks exhibited cost to income ratios of 68 per cent compared to a national average of 60 per cent.¹⁵ ICC Bank did however record significant improvements across all indicators prior to privatisation with a notable reduction in its cost/income ratio from 52 per cent in 1995 to 37 per cent in 2000.

¹³ Between 1980 and the year of divestiture B&I shed 56 per cent of jobs and Irish Steel shed 41 per cent.

¹⁴ In the 1980s both banks engaged in foreign borrowing while lending at “attractive rates”. Government guarantees were in respect of foreign exchange losses on these borrowings. Sweeney (1990:23) reports that in the case of ICC, guarantees amounted to €67.4m in the five years to 1990. These exceeded the banks reserves of €4.4m.

¹⁵ In 2001 the average cost/income ratio (a standard efficiency indicator in the banking sector) in the Irish banking sector was 60 per cent compared to a EU average of 62.66 per cent and a US average of 60.39 per cent (The Banker Magazine, July 2002).

**Table 4: Pre-Privatisation Performance of State-Owned Banks
- Average Annual Rates of Growth (%)**

Company	Employment %	Income %	Sales Efficiency %	PBIT %	ROA%	Cost/ Income %
ACC	3.35	8.40	4.84	8.25	-6.89	0.25
ICC	2.67	11.30	8.54	22.45	1.38	-6.11
TSB	N/A	4.69	N/A	11.25	-0.46	-0.37

Notes: (1) Sales Efficiency = Income/Employees; PBIT = Operating profit before interest, tax and exceptional items; ROA (Return on Assets) = PBIT / Net Assets Employed. Cost / Income = (Operating Expenses – Provisions) / Total Operating Income. (2) Growth rates for ACC based on a four-year average. Growth rates for other companies based are five year averages (3) TSB employment figures unavailable, consequently no figure available for sales efficiency.

The general conclusion therefore is that the pre-privatisation period was one of improved performance for the state-owned banks but that these improvements must be viewed in the context of decades of government subsidisation in the cases of the ACC and ICC Banks. Furthermore, the small scale of operations presented a major obstacle to the achievement of sustained improvements in efficiency and provided strong grounds for a change in ownership

**Table 5: Pre-Privatisation Performance of SOEs sold by IPO - Average Annual Rates of
Growth (%)**

Company	Employment %	Turnover %	Sales Efficiency %	PBIT %	ROCE %
Greencore	-6.47	3.57	11.51	20.09	2.46
Eircom	-1.93	8.49	10.66	5.77	6.00

Notes: (1) Sales Efficiency = Turnover/Employees; PBIT = Operating profit before interest, tax and exceptional items; ROCE (Return on Capital Employed) = PBIT / Net Assets Employed. (2) Growth rates are five-year averages.

Turning to the three SOEs privatised by initial public offerings of shares on the stock market, tables 5 and 6 show that each company exhibited significant performance improvements in the years prior to divestiture. The Irish Sugar Company (now Greencore) implemented an extensive programme of rationalisation before flotation in 1991. Between 1980 and 1990 the level of employment in Irish Sugar was almost halved as the company carried out a number of plant closures and sold a number of subsidiaries. Having reported losses for a number of years in the early 1980s the company returned to profitability and recorded consistent growth from 1986 up to the year of privatisation (Reeves, 1999).

Telecom Éireann (now Eircom) also implemented a large programme of rationalisation in the years preceding flotation. Under the terms of agreements between trade unions and government employment was reduced from approximately 15,000 workers in 1988 to 12,000 in 1999.¹⁶ Impending market liberalisation was a major driver of these measures as well as the decision to

¹⁶ In return for job losses, radical changes in work practices and cost reduction measures of €140m over five years, employees were granted 14.9 per cent of shares in the company. In addition they agreed to contribute 5.3 per cent of salaries to their pension scheme, which historically was funded by the company.

enter a strategic alliance with the Comsource Consortium in 1996. Although full market liberalisation was scheduled for January 1998, Telecom Éireann had faced increasing competition in a number of service markets since the early 1990s.¹⁷ The data presented in table 5 shows that these events were associated with sustained improvements in company performance in the mid-1990s with return on capital employed growing by an annual average of 6 per cent in the five year period before flotation while the average growth in sales efficiency exceeded 10 per cent.

Table 6: Pre-Privatisation Performance of Irish Life - Average Annual Rates of Growth (%)

Company	Employment %	New business (sales) %	Sales Efficiency %	Income %	Excess of Income over outgo %
Irish Life	6.05	10.12	4.11	9.87	3.32

Notes: (1) Sales Efficiency = New business written / Employees; Income = Premium income + investment income; Excess of Income over outgo = Income – (Claims + Admin Expenses + Taxation)

The Irish Life Assurance Company also recorded improved performance prior to flotation in 1991. This can be seen in table 6, which includes performance indicators that are specific to the nature of the life assurance business. The five-year period prior to privatisation was characterised by significant growth in new business and employment as well as sustained improvements in sales efficiency. In addition, the ‘surplus arising’¹⁸ measure which was adopted by the company until 1989 for the purpose of measuring ‘value’, grew by an annual average of 3.3 per cent between 1984 and 1989.

In summary, with the exception of two enterprises that had long-standing financial difficulties (Irish Steel and B&I), the period before privatisation was characterised by improved performance when measured in terms of profitability and labour productivity. For the non-financial companies, rationalisation programmes involving large reductions in employment underpinned improved performance and, in the case of Telecom Éireann, the company faced gradually increased competition since the early 1990s. The financial companies also improved performance before privatisation with the state banks in particular experiencing growth in business and employment during the period of dramatically improved macroeconomic performance. This pattern of pre-privatisation improvements is consistent with findings recorded in studies from other countries (Bishop and Kay (1989), Megginson *et al* (1994), Martin and Parker (1997)). A key question however, is whether observed efficiency gains are ‘static’ or ‘inherently once-off’ as a result of cost reductions, or whether they translate into long-term dynamic efficiency gains that depend more on innovations such as new products and production processes.

4.2 Post-Privatisation Performance

Our examination of post-privatisation performance is confined to the three companies sold by IPO as all other privatised companies were absorbed into the operations of relevant purchasing companies and separate post-privatisation data is not available from published accounts. The data presented in tables 7 and 8 reveals that privatisation has been associated with a deterioration in the

¹⁷ The Terminal Equipment Directive in 1990 and the Leased Lines Directive in 1992 opened up markets for non-voice telephony services and the international call market respectively. In 1996 a licence was granted to the second mobile operator ESAT Digiphone, which set up in direct competition with Telecom Éireann’s mobile arm, Eircell.

¹⁸ Under the ‘surplus arising’ method, all the expenses associated with new business are written off in year one and a conservative view is taken on future liabilities. No allowance is made for future profits on new business.

performance of Greencore and Eircom whilst Irish Life sustained the improved performance observed prior to divestiture.

Over the nine-year period after privatisation Greencore (formerly Irish Sugar) recorded lower average rates of growth in sales efficiency and PBIT compared to the pre-privatisation period. Moreover the important return on capital employed (ROCE) declined on average following divestiture. In 2000 the company reported net losses for the first time since the early 1980s. It should be recognised that Greencore has made significant strategic changes over the last three years. The purchase of Hazelwood Foods in December 2000 heralded a marked shift from ingredients and agribusiness activities to producing for the high-growth convenience food market. The full impact of this strategic change however is yet to be determined.

The privatisation of Eircom in July 1999 led to a dramatic turnaround in the activities and performance of the company. Within two and a half years of flotation the state-owned telecommunications company had de-merged its mobile telephone operation Eircell (May 2001) and the remaining fixed line business was taken over by the Valentia consortium (November 2001). For the purpose of comparability, the data presented in table 7 covers the two-year period between flotation and the break-up of the company. While recognising the limitations of analysis based on just two years the data shows a marked decline in PBIT and ROCE. This is attributable to an increase of 24 per cent in operating costs over the period 1999-2001.¹⁹ These data must be viewed in the context of a marked change in company strategy with the original objective of 'expanding international business' (Annual Report, March 2000) replaced within months by a focus on exiting from certain international and multimedia activities and ultimately the decision to sell its mobile business which accounted for 70 per cent of the company's market value. By March 2002, the newly de-merged company reported after tax losses of over €80 million due to huge write-downs in the value of network assets, the sale of Eircell, and a drop in turnover at some key business units.

Table 7: Post-Privatisation Performance of Greencore and Eircom -Average Annual Rates of Growth

Company	Employment %	Turnover %	Sales Efficiency %	PBIT %	ROCE %
Greencore	9.08	6.77	-0.75	7.09	-3.41
Eircom	3.86	3.39	-0.46	-20.35	-28.93

Notes: (1) For Greencore and Eircom: Sales Efficiency = Turnover/Employees; PBIT = Operating profit before interest, tax and exceptional items; ROCE = PBIT / Net Assets Employed. (2) Eircom post-privatisation figures are 2-year averages. (3) Post-privatisation figures for Greencore are 9-year averages.

¹⁹ An increase in employment from 12,606 to 13,121 was mainly attributable to the growing mobile phone business, which recorded an increase in employment of 611.

Table 8: Post-Privatisation Performance of Irish Life - Average Annual Rates of Growth (%)

Company	Employment %	New business (sales) %	Sales Efficiency %	Income %	Excess of Income over outgo %
Irish Life	0.04	10.43	10.28	6.03	18.97

Notes: (1) Sales Efficiency = New business written / Employees; Income = Premium income + investment income; Excess of Income over outgo = Income – (Claims + Admin Expenses + Taxation). (2) Post-privatisation figures for Irish Life are 7-year averages

In the case of Irish Life, table 8 shows that pre-privatisation performance improvements were sustained following divestiture. These improvements were reflected in the company's share price, which remained above its IPO level from 1993 onwards and by the time it merged with Irish Permanent in 1999 was trading at 317 per cent²⁰ above its IPO price.

In summary, the Irish experience to date denies any simple relationship between ownership and performance. In the majority of cases performance improvements were recorded in the pre-privatisation period. These 'static efficiency gains' are commonly observed in privatisation programmes and are generally associated with rationalisation programmes that include measures such as labour shedding and plant closures.

The Irish privatisation experience has been largely disappointing in terms of performance after privatisation. In addition to the cases of poor performance at Eircom and Greencore, the Irish Steel Company was closed five years after being taken over by the Indian multinational enterprise, ISPAT, with the company citing a failure to control costs (labour costs and electricity costs in particular) as the principal reason for closure. It is particularly noteworthy that Greencore and Eircom were privatised when they were dominant players in their principal product markets. Greencore continued to hold Ireland's EU sugar quota following divestiture while Eircom commanded over 80 per cent of the fixed line market and was one of only two players in the Irish mobile phone market. The post-privatisation records of both companies provide strong support for the argument that competition in relevant markets is an important determinant of enterprise performance.

The case of Eircom in particular raises important questions in relation to public policy. The break-up of the company and later changes in ownership were not foreseen at the time of flotation. It is evident that these changes have not had a favourable impact on the performance and direction of the dominant player in Ireland's telecommunications sector. This is exemplified by severe reductions in the company's capital expenditure programme²¹, which is manifest, for example, in Ireland lagging behind "leading countries with respect to the roll-out of broadband particularly to residential customers and SMEs" (Forfás, 2004: 3). The case of Eircom highlights the wider implications of privatisation policy and demonstrates its importance as an instrument of national industrial policy.

²⁰ At the time of the merger, Irish Life was outperforming the ISEQ index, which increased by 272 per cent over the same period of time since Irish Life's flotation in 1991.

²¹ Capital investment was reduced from €567m in 2000 to €276m in 2002.

5. PRIVATISATION AND EXCHEQUER FINANCES

Table 1 details that gross privatisation proceeds accrued to date by the Irish exchequer amount to almost €8.13bn. Although this represents a considerable boon, the net position of the Exchequer depends on whether the assets are correctly priced and on the issue of direct and indirect costs. The data presented in tables 9 and 10 demonstrate the extent to which these costs and other factors such as debt write-offs ahead of divestiture have reduced the net privatisation proceeds to the exchequer.

In the case of privatisation expenses (direct costs), table 9 shows that for Irish divestitures they amount to an aggregate of 1.41 per cent of gross proceeds (0.84 per cent on average), which is comparatively lower than levels recorded in the UK (see section 2.3).

Table 9: Privatisation Proceeds, Expenses, Debt Write-Offs & ESOP costs: Ireland 1991-2001.

Company	Proceeds (€m) (1)	Professional Expenses (€m) (2)	(2) as % of (1)	Cost of Debt Write-Offs (€m) (3)	(3) as % of (1)	Cost of ESOP (€m) (4)	(4) as % of (1)
Greencore	210.65	1.73	0.82	-	-	-	-
Irish Life	601.93	9.40	1.56	-	-	-	-
B&I	10.80	N/A	N/A	44.44	411.76	-	-
Irish Steel	0	3.59	N/A	43.73	N/A	-	-
Eircom	6,399.91	97.64	1.53	-	-	1,011.48	15.80
ICC	322.27	0.91	0.28	-	-	26.89	8.34
TSB	408.35	0.77	0.19	-	-	38.99	9.55
INPC	20.00	1.43	1.24	90.00	77.59	10.16	8.76
ACC	154.60	0.35	0.23	-	-	12.39	8.12
Total	8,128.51	115.82	1.41	178.17	2.17	1,099.91	13.38

A second set of expenses that reduces gross proceeds includes financial undertakings on the part of the exchequer in order to prepare a company for divestiture. These commonly include debt write-offs and payment of other liabilities outstanding. These are most likely to arise in the case of loss-making enterprises. The sale of B&I and Irish Steel (both loss-makers) involved debt write-offs of over €40m each. The full cost of these expenses is detailed in table 9. While small in terms of total privatisation proceeds (2.17 per cent) the magnitude of these expenses has been considerable in the case of individual companies.²²

A distinctive feature of the Irish privatisation programme in recent years has been the allocation of

²² A noteworthy feature of the sale of the Irish National Petroleum Company (INPC) in 2001 was the government guarantee of over €30m in the case of environmental expenses following transfer to the private sector. A similar indemnity of €12.7m was agreed in the case of ACC Bank. Although these liabilities may not materialise the indemnity represents a significant retention of risk by the public sector.

significant shareholdings to employees as part of the transfer of ownership. These schemes are commonly referred to as Employee Share Ownership Plans (ESOPs), which are normally granted in return for a restructuring and rationalisation deal. The first such scheme was agreed in the case of Eircom, which was floated in 1999. In this case, employees negotiated the ownership of 14.9 per cent of issued share capital in the company. This consisted of an allocation of 5 per cent of the total issued share capital in return for a rationalisation plan and 9.9 per cent of shares at a preferential rate (costing €240m). Based on the proceeds from the sale of the 50.1 percent shareholding sold by the government (the Exchequer received €4.2bn), the 14.9 percent shareholding allocated to the ESOP was worth €1.25bn. The resultant discount therefore amounts to €1.01bn. The negotiation of this ESOP set a precedent. Since the sale of Eircom, ESOPs of 14.9 per cent have been agreed in most subsequent sales. The costs of ESOPs are presented in table 9. They are estimated to have cost the exchequer some €1.1 billion, which represents 13.38 per cent of total privatisation proceeds.

Table 10: Share Discounts in the case of IPOs of SOEs in Ireland

<i>Company</i>	<i>Share Discount at IPO (%)</i>	<i>Total Underpricing (€m)</i>	<i>Total Underpricing (% of Gross Proceedings)</i>
Greencore	11.30	20.34	9.60
Irish Life	4.38	21.66	3.60
Eircom	18.46	777.57	12.15
Total		819.60	9.97

Notes: (1) The discount in case of Greencore includes cost of discount to Beet Growers. (2) ESOP costs are included in table 7.

An important set of expenses concerns underpricing (indirect costs). Measuring the size of the difference between value and sale price is difficult because valuation relies on subjective judgements. Hence, the most expedient and common means of calculating the undervaluation of shares sold by public flotation is to compare the difference between the price at which the government sells the shares and the prices at which they initially trade on the stock market (e.g. after one days trading). This approach avoids the problems that arise if the price is affected by news that could not have been taken into account at the time when the shares were originally priced.

On the basis of this approach, we estimate the extent of undervaluation in the case of the three SOEs that were sold by IPO. The data in table 10 demonstrates that the discounts range from 4.38 per cent (in the case of Irish Life) to 18.46 per cent (in the case of Eircom). The total value of underpricing in the case of the three SOEs sold by IPO amounts to €819 million (almost 10 per cent of gross proceeds) – a sizeable loss of revenue to the Exchequer. Compared to the UK however, these amounts are relatively small in absolute terms and in terms of total gross proceeds. Vickers and Yarrow (1988) calculated discounts ranging from 1 to 36 per cent in the case of IPOs in the UK with an average percentage discount of 19 per cent. Jones *et al* (1999) in their empirical analysis of privatisation share offers across 59 countries, find that the mean level of underpricing or discounting for the 242 IPOs in their sample is 34.1 per cent and 9.4 per cent for the seasoned offers they analyse.

The comparatively low level of discounts observed in the case of Greencore and Irish Life (4.4 and 11.3 per cent respectively) can be attributed to the method of sale chosen by the Government. The sales of these companies were executed in different stages with an initial offer establishing a market price. This allowed later sales to be more accurately priced, thereby reducing the size of discounts. Some authors have argued that this approach to privatisation maximises the returns to the Exchequer (Buckland (1987), Vickers and Yarrow (1988), Jenkinson and Mayer (1994)). This argument is supported by Harris and Lye's (2001) analysis of Australian privatisations, which documents an average discount of 11.8 per cent, a result of the fact that many of the larger divestitures were executed in stages. In the case of Eircom however, the Government elected to sell its entire 50.1 per cent shareholding at the initial public offering. As a consequence, the level of underpricing (18.5 per cent) was significantly higher than in the cases of Greencore and Irish Life. The Government's decision to divest of its entire shareholding reflected the importance attached to attracting small investors. A host of studies have shown that governments sell the shares of privatised enterprises at a discount in order to serve this objective.²³ An underpriced fixed offer can attract considerable excess demand thereby allowing the government to exercise more discretion when allocating shares and create a shareholder list that fulfils its criteria. The revenue that could have been generated had the government executed the sale of Eircom in the same manner as that of Greencore or Irish Life can be seen as a measure of the price put upon 'wider share ownership' by government.²⁴

In summary, the sale of public enterprises has resulted in the realisation of significant revenues for the Irish exchequer over the period 1991-2001. Whereas the costs of privatisation expenses and underpricing have been modest compared to the UK, the amounts are appreciable. Moreover, when the costs incurred in the creation of ESOPs are included the estimate of revenues foregone is doubled to a total of €2.2 billion.

6. DISTRIBUTIONAL ASPECTS OF PRIVATISATION

Privatisation policies have significant effects on the distribution of wealth and resources in society. The social welfare aspects of privatisation have however, received little attention in the international literature, in part due to methodological difficulties. A full assessment of social welfare effects requires a cost-benefit analysis with identification of winners and losers, measurement of the gains and losses and some form of social weighting of the gains and losses before aggregating them. "At this point economists usually retreat, commenting that income distribution issues are beyond their competence. However a proper study of the consequences of privatisation cannot avoid attention to gainers and losers" (Parker, 1999: 30).

Studies that have examined welfare aspects of privatisation tend to be partial and focus on one or a small number of groups affected by privatisation policies.²⁵ Typically these groups include workers (e.g. Haskel and Szymanski, 1993), shareholders (e.g. Saunders and Harris, 1994) and consumers (e.g. Waddams-Price and Hancock, 1998).

For the purpose of this paper we confine our examination of the distributional effects of privatisation in Ireland to workers, investors and consumers.

²³ For example, Buckland (1987), Biais and Perotti (1997), Jones *et al* (1999)

²⁴ A similar point was made by Buckland (1987) in connection with some cases of privatisation in UK.

²⁵ One exception to the 'partial analysis' is a study by Galal *et al* (1994) who assessed the impact of ownership change on all relevant actors and stakeholders in the transactions. They adopted a counterfactual approach in order to isolate the effects of ownership change from broader economic shifts and events.

6.1 Labour

As noted above, Ireland's privatisation programme has had an important impact on the welfare of workers with sizeable shareholdings secured by trade unions as a result of negotiated Employee Share Ownership Plans (ESOPs). The precise details of ESOPs vary from case to case but in general they have involved the granting of free shares in return for acceptance of flexible working arrangements and sale of shares at considerable discounts.²⁶ Table 11 summarises details of ESOPs to date and estimates that at the time of divestiture the value of ESOPs to each individual member ranged from €43,234 to €83,161.

In addition to providing monetary returns, ESOPs have served to allocate significant power and influence to workers. This is illustrated in the case of Eircom where the ESOT (the holding trust which operates the ESOP), which is dominated by the trade unions, held the balance of power in the takeover battle between two rival consortia that followed privatisation. In return for its support the winning consortium, Valentia, granted the ESOP a doubling of its stake and trebled its representation on the board of Eircom.

Table 11: Value of Employee Share Ownership Plans (ESOPs) in Privatised Irish Companies

Company	Shares held by ESOP at time of Sale (%)	Value of Company at time of Sale (€m)	Initial Value of ESOP (€m)	Price paid by ESOP for 9.9% stake (€m)	Number of Employees in ESOP	Value of ESOP per Member (€)
Eircom	14.9	8,407.61	1,252.73	241.25	12,163	83,161
ACC Bank	14.9	165.00	24.58	12.20	450	27,522
ICC Bank	14.9	349.17	52.02	25.14	350	76,819
TSB	14.9	430.44	64.13	25.14	1,200	32,496
INPC	8.8	116.00	10.16	N/A	235	43,234

Notes: (1) All ESOPs (except for the INPC) received 5 per cent of shares free in return for changes in work practices and voluntary redundancies, while the remaining 9.9 per cent stake was purchased by the ESOT at a discounted price. (2) Values per member are approximations (3) Estimates of 'Value of ESOP per member' take account of payments made by ESOTs in return for 9.9 per cent stakes in companies.

Turning to employment, a commonly held view is that privatisation policies are normally associated with reductions in employment levels and diminutions in conditions of work (Martin, 1993). Empirical studies however, fail to provide conclusive evidence on this question.

²⁶ For example, in return for a 5 per cent stake in ICC, the staff agreed to: increasing the hours in the working week; outsourcing of services; an open-ended option to reduce staff numbers on a voluntary basis; transfers within the bank; changes in duties; closer linking of performance and reward; no cost increasing claims to be submitted for a period of three years; and continuation of staff flexibility.

Meggison and Netter (2001), in their extensive review of empirical studies, found that three studies showed significant increases in employment, two studies found insignificant changes while five studies documented significant – sometimes massive – employment declines. The authors conclude that the safest conclusion that they can assert is “that privatisation does not automatically mean employment reductions in divested firms – though this will likely occur unless sales can increase fast enough after divestiture to offset very large productivity gains” (2001: 357). Table 12 looks at levels of employment in privatised Irish companies in the five years before privatisation. Significant reductions in employment are recorded in four of the eight companies examined (Eircom, Greencore, Irish Steel and B&I) while increases in employment were recorded for the other four (ACC, ICC, Irish Life and INPC). Where post-privatisation data is available we find that three companies recorded reductions in employment (Greencore, Irish Life and Irish Steel) while Eircom recorded a significant increase of eight per cent. The absence of any clear pattern is consistent with the findings of studies reviewed by Megginson and Netter (2001) and suggests that the impact of privatisation on employment is industry-specific.

Table 12: Employment levels before and after privatisation

Company	Five Years Before Divestiture	Year of Divestiture	Post Divestiture
Eircom	13,069	12,163	13,121 (2 Years after)
Greencore	2,205	1,874	1,675 (5 Years after)
Irish Life	1,635	2,190	2,084 (5 Years after)
ACC	588	590	N/A
ICC	308	350	N/A
Irish Steel	635	433	407 (5 years after)
B&I	1,411	897	N/A
INPC	223	235	N/A

Notes: (1) Post-privatisation data available for companies that continued as independent going-concerns. (2) Data for TSB not available. (3) At time of divestiture reductions of 140 and 250 jobs were planned for ACC and B&I respectively.

6.2 Shareholders and Other Investors

One important question in relation to the ownership of shares in newly privatised companies concerns the distribution of shares and whether privatisation has attracted significant numbers of small individual shareholders. Earlier privatisations in the case of Ireland were not strongly

justified or advertised as a means of widening share ownership. Nevertheless, when the 39.6 million Greencore shares were initially offered, beet growers and employees had the option of buying more than a 10 per cent stake in the company. In addition, almost 40 per cent of the shares initially offered were sold to small shareholders with the offer 5.5 times oversubscribed.

On the basis of data provided in company accounts it can be deduced that the distribution of shareholdings in Greencore was characterised by stability in the three years following the flotation.²⁷ The data also indicates that although there was a degree of ‘staggering’, this was short-lived and the initial spread of shares was maintained. Smaller investors were also given preferential treatment when allocating shares during the IPO of Irish Life in 1991. Thirty nine million shares (28 per cent of the total issue) were allocated to small investors and policyholders and the offer was three times oversubscribed. Data from annual reports of Irish Life however, indicate that the number of shares held by small shareholders fell considerably (by over 20 per cent) within 4 years of the IPO.²⁸

Although the sales of Greencore and Irish Life involved appreciable allocations to small shareholders they were of considerably smaller scale compared to the case of Eircom.²⁹ In this case the IPO was accompanied by an extensive advertising campaign and attracted over 574,000 small shareholders who purchased 78 per cent of shares floated in 1999. Significantly, when Eircom was broken up in 2001 and separate sales were completed for its mobile telephone (Eircell) and fixed line businesses, the number of small shareholders was 450,000.

Table 13: Real Returns to individual investors (internal rate of return)

Company	IRR after one year (%)	IRR after two years (%)	IRR after three years (%)	IRR after five years (%)	IRR after seven years (%)
Greencore	28.70	21.45	25.31	28.52	27.44
Irish Life	20.07	22.99	14.82	14.22	28.35
Eircom	-21.95	-38.53	n/a	n/a	n/a

The returns accrued by investors in the three companies floated on the stock market are summarised in table 13. The calculation of internal rates of return (IRR) is based on a single individual that invested in the company on day of flotation.³⁰ Whereas annual returns to investors in Greencore and Irish Life exceeded 27 per cent in the seven years after flotation, investors in Eircom incurred average losses of 39 per cent in the two years prior to the de-merger of the

²⁷ Data provided in Company Annual Reports indicates that although the number in the smallest category of shareholders (owning under 1,001 shares) fell by only 9.5 per cent between 1992-94, the number owning between 1,001 and 5,000 shares increased by 72 per cent. Furthermore, there was a 40 per cent increase in the number of shares owned by the smallest two categories of shareholders.

²⁸ Data from Company Annual Reports shows that after the IPO, some 97 percent of shareholders held less than 5,000 shares in Irish Life, which represented approximately 9 per cent of the shares in the company. While the percentage of shareholders that held less than 5,000 shares remained stable between 1992 and 1995, the number of shares that they held fell by 20 percent.

²⁹ In the cases of Greencore and Irish Life, 40 and 28 per cent of shares respectively were allocated to small shareholders.

³⁰ The Internal Rate of Return (IRR) sets the present value of the revenue flow equal to the present value of the initial investment resulting in an annual percentage yield on the purchase price of shares. The yield is based on the assumption that an individual purchased the share at flotation and by taking the yearly dividend flow. All cashflows were measured in real terms.

company.

In November 2001 (almost two and a half years after privatisation), Eircom was taken over by the Valentia consortium consisting of a small group of equity partners and the ESOT. In contrast to small shareholders who participated in the initial flotation, these investors made massive returns on their investment. Within seven months of the takeover a re-structuring of the company's debt yielded a dividend of €12m, which amounted to 76 per cent of the original equity investment. In March 2003 the company was re-floated on the stock exchange with investors accruing a capital gain of over 20 per cent.³¹

6.3 Consumers

Proponents of privatisation commonly cite reduced consumer prices and improved service. This is attributed to efficiency gains being passed on to consumers in the form of lower prices. The experience with privatisation of utilities in the UK suggests that price reductions are dependent on ownership in conjunction with competition, regulation and technological change. There is mounting evidence of falling prices in privatised utilities in the UK, reflecting gains in productive efficiency. Parker (2003) provides some examples: in telecommunications average charges fell by around 40 per cent (in real terms) between 1987 and 1997; in the gas sector, domestic gas bills fell by an average of 2.6 per cent per year after privatisation (in real terms); in electricity a decline of 26 per cent in charges to domestic users was recorded. The exception to this trend was the water and sewerage industry where domestic charges rose sharply after privatisation, by over 40 per cent (in real terms).

It is noteworthy that Parker stresses that the price reductions observed in the telecommunications industry "certainly results from changes in technology and competition in addition to ownership change and regulation" (2003: 13). Moreover the price increases recorded in the water sector reflect the lack of competition in water services since privatisation. Due to limitations in data availability our analysis of the impact of competition and privatisation in Ireland is confined to the case of Eircom where the experience to date exemplifies the benefits of increased competition rather than ownership. In its review of regulatory reform in Ireland the OECD (2001) noted that where competition in telecommunications had developed prior to 1998, the consumer had benefited from significant price reductions. For example, in the case of international calls, competition (mainly through indirect competition, e.g. call-back services) coincided with continuous price reductions since 1994. Ireland's ranking in the OECD basket of international telephone charges fell from 'above average' to less than half the average between 1994 and 2000 (OECD, 2001).

This trend of falling prices for international calls continued after privatisation in 1999 in line with Eircom's falling market share.³² However, in the market for domestic calls where Eircom have held a market share of over 80 per cent since privatisation, only marginal reductions in prices have been observed (ComReg, 2004). In addition, there are indications that privatisation has been associated with reductions in service quality with the former monopoly significantly reducing its number of payphones³³ and the regulator expressing concerns about Eircom's delivery of universal service obligations in relation to connection to the fixed public telephone network.³⁴

³¹ This approximate value is based on an initial equity investment of €676m and proceeds to equity investors of €873m

³² ComReg (2004: 39,48) report that over the period 2002-2004, Eircom's share of the international call market fell from 75 per cent (of revenues) to 68 per cent while prices fell by between 20 and 40 per cent depending on destination and time.

³³ Eircom reduced the number of public payphones from 7,796 to 6,300 between March 2001-March 2003, *Irish Times*, March 13th, 2004.

³⁴ *Irish Times*, April 28th, 2004.

7. CONCLUSIONS

Although comparatively late with respect to initiating a programme of privatisation, Ireland now ranks highly amongst OECD industrialised countries in terms of the proportion of former SOEs sold and the aggregate revenues generated to date. Where privatisation has occurred, policy choices in the main have been driven by pragmatism and considerations specific to individual enterprises rather than doctrine (as was the case in the UK). Patterns are difficult to discern. The first two privatisations (Greencore and Irish Life) were largely prompted by lobbying from senior management who favoured divestiture. The following two sales (B&I and Irish Steel) were attributable to the government's desire to withdraw from enterprises that were financially unsustainable. In recent years privatisation decisions have been heavily influenced by Ireland's membership of the EU. Loss-making companies can no longer rely on state subsidies and are therefore candidates for divestiture while the de-regulation of markets increases the likelihood of privatisation of state-owned utilities (for example, Eircom).

Our analysis of Ireland's privatisation programme focuses on three key aspects: enterprise performance, impact on the exchequer and distributional effects. The Irish experience fails to provide support for privatisation *per se* as a means of improving performance. Significantly, the evidence indicates that two of the three companies examined performed poorly following privatisation while the Irish Steel Company was put into liquidation five years after divestiture. Furthermore, the cases of Eircom and Greencore point to the importance of product market competition as a determinant of performance.

A distinctive feature of Ireland's privatisation programme has been the granting of sizeable shareholdings to workers. ESOPs have resulted in significant redistributions of wealth and corporate power in favour of employees. Moreover, they account for half of all revenues foregone by the exchequer as a result of privatisation policies. Others to benefit from privatisation programmes include investors but these in the main have been large and institutional investors as the vast majority of small shareholders to date were investors in Eircom who incurred sizeable losses.

As most of the enterprises remaining under public ownership reside in strategically important sectors (for example gas, electricity, transport), relevant lessons can be drawn from Ireland's biggest privatisation to date – the former public utility Eircom. Since divestiture in 1999 the company has been de-merged, de-listed and re-floated. These changes have significant economic and social effects many of which were unexpected at the time of privatisation. They underscore the importance of framing privatisation decisions as part of a coherent overall industrial policy and draw attention to the magnitude of the regulatory challenge posed in the post-privatisation environment.

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