

Privatization, Deregulation, Reregulation - Experiences and Policy Issues in Austria

1. Theoretical Aspects

1.1 Market failures and regulation

The necessity for regulatory interventions generally arises under allocation-theory aspects in the case of market failure. Concerning the theory of regulation and public enterprises, the most important form¹ of market failure is a natural monopoly. A natural monopoly due to technical properties is characterized by steadily decreasing average costs that allow one single large supplier to produce the quantity demanded by the market at lower costs than would be possible by a greater number of firms.

In this respect, some production technologies like railroad transportation, telecommunication and the distribution (not the production) of electricity show characteristics like indivisibility and network-inter-linking that make it more cost-efficient to organize the production in a single enterprise instead of in several. Both, with the railroad and the distribution of electricity, as well as with the provision of water or natural gas, competition between two enterprises would mean a doubling of the supply network and thus result in avoidable costs.

If the conditions for a natural monopoly exist, it is reasonable from an economic policy point of view that the state intervenes. This is accomplished either by a takeover into public ownership or by the issue of a monopoly license and strict public supervision, coupled with a regulation on price or quantity. Whether the form of public enterprise or regulation is chosen, is on one hand a question of an economically efficient solution of monopolistic problems, on the other hand a question of social and historic conditions and traditions. Several problems should be solved simultaneously by the monopoly regulation or the public enterprise: on one hand the exploitation of technological efficiency and cost efficiency and on the other hand a restriction of the market power resulting from it.

¹ Other forms of allocative market failures that are relevant for questions of regulation and public enterprises are the existence of external effects and uncertainty.

In contrast to this, especially W. Baumol (1982) has developed the "Theory of contestable markets" which wants to show that such natural monopolies don't necessarily have to be in public hands nor be regulated by the state in order to achieve optimal allocation. The theory states that competition in the market is not necessary to bring about an optimal allocation in natural monopolistic markets. The threat of market entry, in other words potential competition, is sufficient. One can take this as the attempt to generalize the model of perfect competition to cover all forms of markets by use of the model of the perfectly contestable market. The main emphasis is being laid on the potential competition – certainly under strongly idealized market conditions, for "a contestable market is one into which entry is absolutely free, and exit is absolutely costless" (W. Baumol, 1982).

However, these conditions are not in effect when "irreversible costs" (sunk costs) exist. These are costs that - once spent - can not be recovered by the firm concerned when exiting a market. Examples for these costs are expenditures for research and development and for underground pipeline - and communication networks. Since in these cases opportunity costs are zero – an alternative use is not possible (anymore) -, a cost asymmetry exists between the "established" firm and a potential new competitor who would have to make the correspondent fixed investment beforehand. Irreversible costs can therefore constitute a barrier of entry into the respective market and can give the existing enterprise a – even though not unlimited - monopoly situation. This monopoly power can be used to reap monopoly profits at the detriment of the consumer. It is a fact that industries that show characteristics of natural monopolies are usually also characterized by the existence of substantial irreversible costs. This requires therefore appropriate public interventions in the form of regulations or public enterprises.

Regulation and antitrust policy come from the same historic roots. Antitrust policy in the USA is based on the objective to organize the market processes by means of restriction-free competition. Public regulation is required when such competition fails to organize the market processes or cannot take effect at all. On one hand, economies of scale can lead to natural monopolies². On the other hand, due to special economic conditions, frequent and damaging price wars can break out and destroy productive capacities. In the first case, the regulating commission must monitor private monopoly power and in the second case, it must limit and regulate the competition. Both cases are about simulating competition in cases when it can not take place or should not take place by bureaucratic decision-making processes. This is in regard to specific results like optimal allocation of resources, optimal price setting, quality of production and –safety. The European form of regulation has aimed and aims not only at the prevention of an exploitation of consumers and an abuse of market power, but had from the start "general economic policy" objectives (especially regional- and social policy goals).

1.2 Forms of Regulation

In monopolistic as well as in competitive structures, the most important starting points of regulation are:

- Barriers of entry into markets – Corresponding rules span from the awarding of a lawful monopoly position through the demand examination to the concession, respectively – with the lowest intensity –to reporting requirements and sometimes also involve investment authorizations for new capacities.
- Price regulation – respectively regulation of the tariff level and –structure, involves profit-and cost control. The various intensities of the intervention are: price setting, the setting of lowest-/highest prices and mandatory price reports.
- Setting of quality-standards and working rules – in the form of standards, minimum quality setting, and mandatory tariff disclosure for the protection of the consumer. Often it is not possible for the consumer to have full information concerning the quality of the goods and services at the time of purchase, but only in the course of their use. Uncertainties can also arise regarding the reliability of certain sellers. In these cases asymmetrical information between the buyer and seller exists. Regulation in the form of certain quality standards or in the form of liability regulations should create at least a partial remedy for this problem.
- Obligatory contracting – here the conditions are laid out under which the regulated enterprises are obliged to offer their services to everyone. The consequence is that, it is not alone the enterprise' s decision to leave a market because by doing so it could evade its obligation to provide services.

This catalogue comprises the traditional regulation of utilities. However, not in all regulated industries do the same interventions appear. Energy suppliers, for example, are forced, through regulating interventions, to hold options for demand that will be exercised only in times of crises. Thus, the scope and the instruments of regulation are not fixed.

Many of the political and economic goals of regulation, like the distribution and allocation policy objectives, can be reduced to the question of an optimal price level, respectively an optimal price structure. Therefore, the existence of a natural monopoly means the search for a price vector that allows cost covering and at the same time minimizes welfare losses. Regional and allocation policy goals can, although disputed, be met, for example, by a tariff structure with internal subsidies. A special form of the price regulation is the profitability regulation. This includes the yield rate regulation (a limit on profits; the enterprise will receive a certain maximum return on the employed capital) and the cost-plus regulation (a limit on profits; the enterprise will receive a premium over its established costs, corresponding to a mark-up price strategy).

Price setting, market entry regulations, quality standards and provision of service belong to the group of the so-called "administrative regulation" of the external regulation. However, the actual spectrum of the regulative measures is much wider. In external regulation, the following alternatives can be differentiated comp. Nowotny, 1996a):

² A natural monopoly exists when the average costs in an economic sector fall along the total production curve (until the capacity limit).

- Administrative Regulation: Poses extremely high requirements for information, because the regulating commission has to know the production-, the cost- and the demand conditions. However, it is dependent on the information from the regulated firms – (problem of asymmetric information!).
- "Incentive" Regulation: Is essentially about trying in different ways to create incentives for a management under limited market entry conditions to act efficiently and to minimize the information problem, for instance through a corresponding reward system for the management or the employees.
- Price Limits: There is no limit on the permissible profit. The path of the average pricing level that is conceded to the enterprise follows an indicator for the general cost increases. This indicator is adjusted by a factor X which takes the future development of productivity at the enterprise into account.
- Yardstick-Competition: With the absence of competition as an information-generating mechanism, a reduction of the information problem can come from the use of information from other regulated firms (yardstick-competition). This is the attempt to use the regulation process to create an indirect competition between firms or divisions that are not engaged in direct competition. An alternative proposal for generating "pseudo-competition" is "franchise-bidding" – a process to master the efficiency problems of natural monopolies: a protected monopoly situation is periodically offered for tender and awarded to the best bidder³.

2. Public Enterprises as Instruments of Economic and Social Policy (Theory of Co-operative Economics, "Gemeinwirtschaft")

The co-operative economic theory of public enterprises described below should not be seen as a contrast to the neo-classic approach discussed above. Its emphasis is different, with a stronger regard of (personal and regional) distribution effects besides allocation effects. The concept of co-operative economics corresponds to the interventionist view of the public sector with the belief that it is the function of the public authority to represent "common economic" and "common social" interests, which can also be in opposition to individual interests. These common interests have to be established by means of democratic processes (elections). Besides public revenues and expenditures and forms of public regulation, instruments for reaching these common interests can also be co-operative enterprises.

Co-operative enterprises are firms that have no private owner whose income- and/or wealth maximization has to be met. Instead, they are operated by a public entity with goals that go beyond the microeconomic profitability target. Such entities are not only public households but also, for example, associations (unions) and co-operatives. The concept of "co-operative economics" is therefore defined functionally. That means a firm behaves economically co-

³ The franchise is given to the bidder who is prepared to offer the lowest prices for the consumers or can be awarded to the bidder who is prepared to pay the highest fee for the license. The outcome in the former case ideally leads to optimal efficiency of allocation. In the latter case, an optimal allocation result is not possible. However, the licensor is able to absorb a good part of the monopoly surplus. To arrive at an efficient outcome, a number of conditions must be met: the auctioning process must be sufficiently competitive; that means

operative, when its business conduct is not (entirely) determined by the goal of individual profit- or wealth maximization, but instead by a correspondingly defined common benefit objective, which goes beyond the social responsibility that enterprises regularly bear.

Co-operative behavior is often coupled with the goal of self-sustainability in the sense of cost covering to allow public enterprises to reach common beneficial goals in a market-conforming way. This dual concept (co-operative behavior and self-sustainability) can lead to problems. There exist the following to harmonize these goals (T. Thiemeyer, 1975, S. 23):

- Profit maximization under restrictions (co-operative economic functions)
- Loss minimizing as profit maximizing behaviour (minimizing the deficit that occurs from pursuing co-operative economic objectives)
- Public interest oriented use of profits (co-operative behavior is sought by the use of profits).

The view of co-operative economic enterprises as instruments for reaching economic and social policy goals is reflected in the concept of the Instrumental Theory of Public Enterprises. Objectives that might call for the use of public enterprises as policy instruments are:

- competition policy goals, i.e. co-operative economic enterprises in the role of “natural monopolists“ or as countervailing-powers to enhance the intensity of competition in oligopolistic markets;
- economic growth goals, i.e. realization of risky economic innovations within a timeframe that private investors could not sustain;
- local policy goals, i.e. direct application of local political concepts instead of a subsidy policy for private firms;
- regional policy goals, i.e. with respect to housing policy, workplaces, installation of infrastructure and recreational zones;
- social policy and distribution policy goals, i.e. with respect to pricing, services rendered, company-internal social policy;
- economic-cycle- and employment policy goals, i.e. the use of public enterprises to help overcoming structural crises (bail-out companies for restructuring purposes etc.), consideration of overall economic aspects in the price- and wage policy of public enterprises;
- domestic policy goals, i.e. the prevention of political abuse of economic power
- foreign policy goals, i.e. the prevention of undesirable economical and political influence in the case of foreign ownership in core industries⁴.

the number of bidders must be large enough to eliminate coordinated behavior. Furthermore, the extent of irreversible costs as well as high transaction costs must be considered.

⁴ Political goals, based on such experiences, have played (and play) a substantial role in the nationalization processes that took place in France (i.e. Renault) and partly also in Austria after WW II.

The question whether the above-mentioned goals and other economic and social-political objectives should be pursued completely or partly by the use of public enterprises or direct public interventions (rules and prohibitions), or alternatively by the conventional instruments of public expenditure and revenue, is primarily a question of the relevant technical efficiency of the individual instruments.

However, the choice of instruments has limitations that need to be considered in the course of economic policy action. Particularly, it has to be taken into account that tEU-law and in general the growing internationalization curtails the choice of instruments of co-operative economic enterprises that are profit-oriented and subject to private competition. It can be said in general that the various forms of markets, in which a co-operative economic enterprise is active, are decisive for their economic policy use. From a political science point of view and from the point of view of public-choice approaches, problems of the instrumental thesis arise from the fact that public enterprises are part of a complex political process. For this reason, they are subject to very diverse political demands, different normative-political trends, ad-hoc influences, historically changing circumstances, traditions, consensus mechanisms and other political variables. Limits for the instrumental functions can arise from the number of different reasons for the creation of public enterprises, from the different ownership situations in a federal structure, from different legal entities, and market forms, but also from the different shareholder situations in the case of mixed public and mixed private enterprises.

3. The Many Meanings of Privatization

A wide range of measures can be summarized under the concept of privatization. In a narrower definition privatization is the transfer of ownership of public enterprises to private entities (a partial transfer is called hybridization). However, in the course of a privatization not only the owners will change, but also the organizational structure, the goal function, the financial structure and the way these enterprises are integrated in the public sector. Efficiency increasing effects are expected above all as a result of changing controlling mechanisms that are connected with ownership. Privatizing measures are not necessarily connected with deregulation measures. A system change from internal regulation to external regulation is also a possibility. Alternatively, deregulating measures can be taken at public enterprises without privatizing them at the time.

In privatization processes, the form of the market, the firm is active in, always has to be taken into account. When a public monopoly is turned into a private monopoly and when it is a production with irreversible costs, the newly created private monopoly needs to be regulated. The inseparable interplay of ownership, competition and regulation in the event of privatizing monopolies requires attention. Especially within respect to utilities, privatization means a change from a system of internal regulation to a system of external regulation.

It is not guaranteed, however, that privatization automatically brings an increase in overall economic efficiency. Privatization also means a change in the institutional structure and a change of the information flows. This presents the chance of a change in efficiency. Should the shareholders demand higher profits and thus higher internal efficiency, the management might have an incentive to meet the pressure for higher profit-orientation through an abuse of monopolistic market power (with higher prices and rationed supply). In general, the objective of the regulator does not have to change because of a privatization, and neither do the objectives of the management. The only difference lies in the addition of shareholders, which cuts the regulator's direct grasp on the management. That means he is confronted with another information barrier. Under certain constellations, this institutional change can lead to an increase in the X-efficiency while at the same time the overall economic benefit deteriorates (D. Bös, 1993).

Aspects of privatization are relevant not only for the field of public enterprises and public shareholdings, but also for the direct provision of services by the public sector. A distinction should be made between a complete transfer of a responsibility from the public sector to the private sector (i.e. the sale of a state-owned forestry) and a change in the direct public intensity of expenditure with a continuation of a public function. In the latter case of a "privatization of functions" (contracting-out), the scope and form of the public function is still determined by the state, while the performance of the function is handed over to private parties (i.e. cleaning and repairing services, waste disposal).

Under the aspect of privatization, also changes in the organizational form are discussed where the performance of public functions is transferred from public law- to private law organizations (i.e. a corporation) without a change in ownership (i.e. for the realization of construction tasks by specialized road construction companies). The enlistment of private businesses, respectively private law organizations, is supposed to enable cost savings through greater flexibility. On the downside, the transfer of financial duties to "out-of-budget" public enterprises can also bring problems associated with an "escape from the budget".

In general, an assessment of deregulation- and privatization approaches calls for an all-comprehensive view that takes a multitude of aspects into consideration:

- Under static allocation aspects, a cost-benefit examination is necessary that confronts the significance of market failure on one hand with forms of public failure on the other hand for every single case. An example is the question whether the risk of bankruptcy that constitutes a market economy should affect enterprises in the utility sector (i.e. provision and disposal of electricity, water, waste) or to what extent the state should eliminate this risk by actual or formal existence guarantees in the interest of reliability of supply. In the latter case, the danger of a negative incentive structure for private operators is present in the sense of a "privatization of profits" and "socialization of losses". Corresponding experiences lead to many municipal take-overs in the beginning of this century.

- A dynamic examination has to take into consideration how far the market constellations at the supply side and the demand side have changed through technical or institutional developments over time. This concerns, for instance, changes in the character of natural monopolies brought by technical advances or processes of international market openings. In the same way, it is important to know under a dynamic examination, how it can be avoided that after deregulation- and privatization measures, new oligopolistic or monopolistic structures can develop over time through mergers and acquisitions, and how such structures can be controlled under overall economic aspects respectively. Corresponding discussions are taking place, for instance regarding the development in certain market segments in the telecommunication industry and local markets in the utilities sector.
- A special allocation aspect is the necessary consideration of social costs and benefits in contrast to the business point of view. Increasing significance goes to the consideration of environmental aspects, which show the limits of deregulation (i.e. in the transportation sector) on the one hand, and the need for new regulative measures (reregulation) on the other.
- In a more general sense allocative considerations should also include "co-operative economic" objectives like reliability of supply and/or regional policy aspects in its overall economic assessment. For instance, this is important for mail- and public transportation services. The question of comparability of quality- and safety standards needs to be dealt with here.
- For an overall judgement, the distribution policy effects of deregulation and privatization have to be taken into account. One has to examine not only the distribution effects between the producer side and the consumer side, but also particularly the impact on the functional and personal distribution of incomes. This impact can be created by the asynchronous development of wages and profits or by real-income effects, which vary for different social groups because of changes in price structures created by deregulation. The impact can be significant when services, which have a comparable higher weight in the household budgets of recipients of lower incomes, go up in price because of a loss of certain cross-subsidization's or pay scale reforms (i.e. the setting of basic rates for electricity and utilities or of transportation fees).

In conclusion, it becomes apparent that microeconomic efficiency criteria are undoubtedly important, but not the only decisive factors in questions of deregulation and privatization. Rather, conflicts of goals can occur in various forms. The solution to these conflicts can vary internationally and in the course of time in each case according to social politic, economic and technical circumstances. Austria is a good example for this kind of conflicts and discussions.

4. Starting Points and Forms of Privatization in Austria

2.1 The starting point

Compared with other countries with free-market economies, Austria has a greater proportion of various kinds of public ownership,⁵ although, as shown in Table 1, this proportion is by no means a predominant one and is declining. Also characteristic is a comparatively larger - and now increasing - proportion of foreign owners, 39.3 per cent of whom were from Germany in 1989 and 16.2 per cent from Switzerland and Liechtenstein. Thus the proportion of foreign ownership of corporations was 44 per cent in commerce and 51 per cent in the insurance sector. The public sector occupied a strong position as the owner of business enterprises mainly in the energy, industrial and banking sectors. Now only the sector of electric energy is still under public majority ownership.

The causes of the relatively large involvement of the central government, *Länder* and local authorities in various areas of the economy and infrastructure are to be found in Austria's historical development and experience. Following the mercantilism of the eighteenth century, it was mainly the social injustices and abuse of private monopoly positions in the nineteenth century that resulted in initiatives directed towards expansion of the public and cooperative sectors. Examples of this are the founding of the cooperative movement in agriculture and, in the urban areas, the establishment of municipal and trustee savings banks, and the setting up of comprehensive municipal service enterprises. The economic crisis after 1929 compelled many government takeovers, particularly in the banking sector with its extensive company holdings, in order to prevent company collapses and the ensuing massive economic costs.

Table 1 - Employees in the Austrian Economy by Majority Owners, 1989

Enterprise owner	Proportion of employees (percent)	Proportion of nominal capital (percent)
Domestic private ownership	65.8	35.4
Foreign	19.8	25.1
Federal government	10.3	25.8
<i>Länder</i> and local authorities	3.5	7.0

⁵ Across Europe, the public enterprises' share of employment in the economy as a whole in 1988 was as follows: Germany (1985 figure) 7.8 per cent; France 13.3 per cent; United Kingdom 6.0 per cent; Italy (only the industrial, commerce, transport and communication sectors are recorded) 25.0 per cent; Austria 14.2 per cent (as share of trade and industry, 20 per cent) (Obermann and Soukup 1992, p. 25).

*Enterprises of more than 20 employees were recorded: 90 per cent of all employees in industry were recorded, while in sectors structured as very small firms, such as commerce and trade, only 65 per cent and 69 per cent of firms were covered, respectively. Source: W Goldmann (1991, p. 63).

After the end of World War II an extensive program of nationalization was carried out in the mineral extraction industry and electricity sector by means of two nationalization acts. One justification for this was the takeover by the re-established Republic of Austria, after the occupation, of German property - as a measure designed to safeguard the country's economic independence. Another reason was that the state was the only party willing and able to organize and finance the construction of large-scale industries, most of which had been destroyed during the war.

It is important to be aware of this historical background in any discussion of privatization, as it indicates that questions of ownership rights cannot be discussed independently of the prevailing economic and social circumstances in a given country and that the indiscriminate transfer of international 'standard models' can frequently give rise to problems. A more comprehensive approach will also show to what extent justifications of public ownership are still relevant today (e.g. in relation to any leeway in the shaping of a government's economic and social policies and preventing abuses) and to what extent political and economic conditions have changed (especially as a result of the opening of international markets for goods and capital. Nowotny 1996, b).

2.2 Forms of Property Privatization

As has discussed above the concept of privatization can be interpreted in very different ways in scholarly and political discussions. Important examples of types of privatization are:

- (i) partial or complete transfer of ownership of public enterprises or state property to private individuals;
- (ii) partial or complete transfer of the provision of goods and services to the private sector (contracting out, organizational and functional privatization);
- (iii) 'legal privatization' that is, conversion of the organizational and legal forms of public enterprises (e.g. granting public undertakings independence under public or private law);
- (iv) changes in in-plant structure and adoption to a greater extent by the management of public bodies of private-sector patterns of behavior (transformation of enterprise objectives, marketing strategies).

The following discussion will focus on privatization of property. It should, however, be pointed out that there are also many other examples in Austria of other types of privatization. These include conversion of former federal undertakings into enterprises with their own legal form and their own corporate responsibilities, as happened as early as 1969 with the Austrian Postal Savings Bank and more recently with the railway and postal services. Other examples are the Austrian government printing works, the federal publishing house, and recently even the Federal Government's Theater and Opern Group.

As regards the privatization of property, the most important and politically sensitive area in recent years related to industrial enterprises that had been (or are) combined in the state group of industrial companies, ÖIAG (or Austrian Industries). This involved the leading Austrian enterprises in the iron and steel industries, the oil industry and to some extent the chemical and mechanical engineering industries. At the time of its greatest extent (1975), the ÖIAG group had 120,000 employees or approximately 18 per cent of all persons employed in industry. The impetus for extensive privatization measures in the areas covered by ÖIAG was mainly from the following developments (Bartel and Schneider 1991):

(i) Major losses were incurred by the nationalized industrial enterprises because of the slump which began in the early 1980s (the second oil shock), a prolonged worldwide steel crisis in particular, and also because of serious individual management errors. From the mid-1980s there was no longer a readiness or (financial) ability on the part of the state to contribute to covering losses. Rationalization of the nationalized industries therefore had to be carried out with their own resources, and it had to be financed through sales of enterprises.

(ii) A 'demand-side' approach in economic policy and the ensuing international tax competition resulted in a drastic reduction of the public sector's financial margin. This led to increased pressure in the direction of use of the proceeds from privatization as an instrument for achieving (one-off) deficit reductions.

(iii) A generally conservative reorientation of economic policy increased unemployment rates throughout Europe during the 1980s, and this was partly reflected politically in more intense conflicts between the private and public sectors of the economy. In Austria this resulted in declining political support for the nationalized industries.

(iv) Managers of nationalized enterprises were interested in privatization measures mainly because they (rightly) expected greater independence, a greater degree of managerial leeway and an improved public image for the enterprises. Expectations of an improvement in their own incomes may also have played a role, although the income increases granted in Austria never turned out to be as excessive as those in the context of the British privatization process.

(v) There was strong lobbying from national and especially international investment banks. Privatization has become a big and profitable business, so it can be expected that powerful interest groups will promote this business.

The trends indicated above led to extensive restructuring as regards the size and type of nationalized industries in Austria. The first listing of an ÖIAG enterprise on the stock exchange took place in November 1987, with the transfer of a 15 per cent stake in the state-controlled OMV group of oil companies. After additional partial sales, the first privatization of a majority stake in an ÖIAG enterprise took place in July 1993 through a transfer on the stock exchange (Austria Microsystems).

The legal basis of ÖIAG was then changed by the ÖIAG Act and a 1993 amendment to the ÖIAG Financing Act. ÖIAG is now bound to transfer within an appropriate period of time a majority of its direct holdings in industrial enterprises. Where this appears economically appropriate, individual firms or indirect holdings, especially those which do not form part of the core business of an enterprise, can be transferred separately. In this connection care must be taken to ensure that Austrian industrial firms are preserved and that net industrial output is maintained wherever this is economically justified (section 1(4) of the ÖIAG Act).

In the case of enterprises in which it has a direct or indirect majority holding, ÖIAG must work towards ensuring that the measures required for creating the most favorable conditions possible for privatization are taken. Existing enterprises in particular can be merged where appropriate into groups of companies (section 15 of the Shares Act and section 115 of the Public Limited Companies Act). ÖIAG may issue instructions and guidelines only for the purpose of implementing these measures. The individual enterprises have complete corporate independence in all other respects.

From the standpoint of industrial policy, there is therefore no longer any difference between companies in private ownership and enterprises which are owned wholly or partly by the state. As enterprises with minority holdings are no longer included in the consolidated ÖIAG group and because of personnel reductions, the number of employees in ÖIAG enterprises fell dramatically, from 77,731 in 1992 around 4,800 in 1997. If one adds the companies, where ÖIAG holds minority positions the total number (1997) is 46,243 employed. On the other hand the value of ÖIAG related companies now amounts to 112 bill. Austrian Schillings (1997).

From a technical point of view the privatizations conducted through ÖIAG were carried out in a very professional manner, and there was cooperation with the relevant international investment banks. The basis in each case was a general 'privatization checklist', with the aid of which action was taken in collaboration with the enterprises involved (see Appendix). This 'privatization checklist' had been developed by ÖIAG and was used as a guide for every major privatization project in Austria. This checklist is an interesting document, as it demonstrates the intention to consider not only micro-economic but also macroeconomic and market-oriented aspects of privatizations. This is especially reflected in paragraph 5 (compatibility with Austrian interests), which deals with the effects on Austrian know-how and the potential impact on Austrian suppliers and customers, etc. The know-how acquired in connection with the privatization of the nationalized industries is now being used in order to have ÖIAG act generally as a 'privatization

agency' for the federal government. ÖIAG was therefore placed under the jurisdiction of the Ministry of Finance in 1996, after a reorganization of ministerial portfolios. The Ministry of Transport and Public Enterprises was split up.

5. Privatization - Economic Results

The privatizations carried out among the previously nationalized industries (ÖIAG) have so far yielded sales proceeds totaling 20 billion Sch, and an additional sum of 4.6 billion Sch was raised in connection with capital increases through the issue of new shares. This made it possible on the one hand to relieve (to some extent indirectly) the strain on the government budget and, on the other hand, to improve the equity capital structure of the relevant enterprises. In each case regard was also had to the structure of the buyer, as defined in the criteria contained in the Appendix. While 90 per cent of privatizations were carried out on the stock exchange, an effort was also made to achieve an appropriate domestic ownership component through the granting of a preference to employees and of an Austria bonus' in the case of shares held for a longer time. It is not possible to ascertain exactly how successful these attempts were. It is estimated that around 50 per cent of the shares issued are still in private Austrian ownership. In the case of foreign shareholders, special institutional investors (e.g. pension funds) geared to long-term investments were approached. Long-term experience with the behavior patterns of their shareholders is still lacking, and this has given rise to an additional factor influencing the enterprises and Austrian economic policy (e.g. tax policy).

From the standpoint of the capital market, privatization policy has resulted in a significant upgrading of the role (although generally limited) of the Vienna stock exchange. Of the total volume of new issues on the Vienna stock exchange during the period 1992-97, almost 45 per cent were accounted for by issues by ÖIAG enterprises, while 34,5 per cent of the turnover on the Vienna stock exchange was accounted for in 1997 by shares of privatized enterprises. Since 1993, the performance of these shares has been significantly better than that of the trend for the stock exchange index as a whole. Largely because of the banks of issue, the issue prices have always been very favorable, possibly too favorable, and this has been reflected in a large amount of goodwill towards new issues.

In the case of the privatized enterprises, the trend has been an entirely positive one. This applies in particular to the former ÖIAG flagship, Voest-Alpine Stahl AG, which is now one of the most efficient steel producers in Europe. Operating income rose from a deficit of 71 million Sch in 1993 to 3,2 million Sch in 1997. It cannot be clearly established analytically to what extent these positive trends are linked with changes in ownership rights. In any event, privatization has provided the enterprises with greater independence and therefore greater entrepreneurial leeway. It has to be noted however, that trade-unions have an influential position both within ÖIAG and within each single company, as they are for instance represented in the supervisory boards (Aufsichtsrat). This has proved to have positive effects because a close cooperation and mutual understanding between management and employees greatly increases the chances for a successful policy of privatization (for similar results in Eastern Europe comp. Uralic, Vaughan-Whitehead, 1997). Entrepreneurial independence was to be assured not only vis-à-vis the former

government owner, but also vis-à-vis any takeover attempts by large (foreign) competing firms. A strategic minority holding of ÖIAG or friendly companies was therefore retained in most of the privatized enterprises. The reason for this is that, in view of the small size of Austrian companies on an international scale, there is always a danger that some of these companies will be bought up by competitors simply in order to obtain access to markets and know-how. This experience of destruction of viable industrial assets had to be undergone in Austria to some extent in connection with sales of industrial holdings by the large banks.

The policy of using public enterprises as an instrument of macroeconomic stabilization was followed only briefly, in the 1970s (Nowotny 1982). It was successful at the time, and it helped to avoid hysteresis effects, that means, a perpetuation of unemployment. Thus it contributed to the fact that Austria's rate of unemployment (4.2 per cent in 1998) still is significantly below the rates in most Western European countries (e.g. 9.8 per cent in Germany, and 6,5 per cent in the UK). However, in a situation of structural crises in the steel industry and prolonged recessions, an employment-oriented policy involving nationalized industries and public enterprises could not be followed any longer.

In general, a clear distinction also needs to be drawn between companies which are fully exposed to international competition and those which, at least in certain branches, are 'natural monopolies' in economic terms. This applies in particular to the utilities, where social policy requirements play a special role in relation to tariff structures, density of supply and safety. Care must be taken in this regard to ensure that, with the cessation of public ownership, a "regulatory vacuum" does not arise which could result in abuse of a market-dominant position at the expense of the consumer. Abolition of internal regulations in public ownership therefore must go hand in hand with the establishment of external regulatory bodies (Schneider and Hofreiter 1990).

6. Public Utilities and Services : Public or Private Provision - Deregulation or Reregulation?

Some additional important areas of the public sector will be briefly described below in connection with Austria's experience of privatization.

In the electricity sector, 49 per cent of the state's holding in the largest Austrian power supply enterprise, the Verbundgesellschaft, was privatized, while a federal majority holding of 51 per cent was constitutionally established at the same time. It is noteworthy that the proceeds of this privatization were used to subsidize a special technology policy fund (ITF Innovation and Technology Fund). In the case of the power supply enterprises owned by the federal *Länder*, some minority holdings were also sold through the stock exchange.

In connection with the reorganization of energy policy in the context of the EU internal market a new Energy Organization Law (ELWOG) has been passed through Parliament in July 1998. The aim of this law is, on the one hand, to ensure compliance with the EU directives and, on the other hand, to ensure that policy leeway will be maintained in the energy sector for an independent Austrian policy where environmental, regional and social aspects are involved (e.g. the ban on nuclear power in Austria).

Given the EU emphasis on price competition via an open internal European market it proved very difficult to combine the different aspects, stated above. In practice the new law will bring full price competition after an adjustment period ranging till 2002. It then will be very difficult to follow specific environmental or economic policy concerns - especially there will be no specific protection for Austria's hydroelectric system of energy-production. The government still holds 51 per cent of shares of Austria's electricity holding-company (Verbund-Gesellschaft), but in line with EU philosophy there will be a clear distinction between ownership and regulation. This new regulating agency will have to deal with a number of sensitive problems. One, for instance, is the question of "stranded investments", i.e. investments (especially in hydroelectric power-plants) that were undertaken as a result of government policy, but that will turn out inefficient under the new market-price regime. In accordance with EU-authorities the volume of these "stranded investments" has to be fixed and a decision has to be found, how to compensate power companies for these investments (e.g. by adding a special cost element to the user fees for electricity networks).

Similar developments of "market-opening plus regulation" are to be found in the field of telecommunication and soon will take place in the natural-gas industry. The (at least: immediate) winners of these liberalization-strategies tend to be the big players both on the supply - and the demand side.

On the supply-side this has led to a tendency of take-overs and other forms of concentration, that many prove problematic for future market structures. On the demand side international experience (especially in the UK) has shown a tendency, that the benefits of liberalization go mainly (or exclusively) to big customers which are in a position to use their market-power. For private consumers and small enterprises - which before liberalization profited from cross-subsidization - deregulation-benefits only - if ever - arrive at a later stage or in some cases are in the contrary turned into higher user-costs. To prevent such a development in the field of electric energy supply the new organization law contains a stand-still clause for electricity prices for private consumers till 2002. In the field of telephone services special regulations exist for safeguarding (minimum) "universal services".

A further new field in providing public services are "private-public-partnerships". Following a European trend, projects for private-public partnerships are being discussed also in Austria (Gehart 1996). As part of the European Growth Initiative 1993 the concept of Trans-European networks (TENs) for various fields of infrastructure was developed. These TENs should be basically financed by a source of private capital - as a shareholder, as operator of a project under a concession, as a risk-sharing contractor or as simply a provider of debt finance. Complementary

Community guarantees or Community loans (via the European Investment Bank) would be contracted with individual project promoters.

As Austria has to bear a heavy burden of European North-South and East-West traffic, the Austrian government is extremely interested in European transport networks as a means of reducing the associated ecological and political problems. Austria is thus prepared to form relevant private-public partnerships to finance these TENs. Private-public partnerships have also been proposed as a means of 'privatizing' the Austrian highways. Austrian companies are already active in such partnerships in Hungary. A necessary precondition is the introduction of road pricing systems, which is planned to be introduced in the next few years.

7. Public or Private Provision of "Social Infrastructure"

Beside industry and public utilities there is a third field where there is an intensive discussion with respect to privatization, regulation and deregulation - in Austria, as well as world wide. This refers to the wide field of "social infrastructure" which includes health-services, education, security, etc. (comp. Schuppert, 1998).

If one looks at empirical data it is a fact that the "security-related" service sector. has shown substantial increases in "production" and employment shares. The controversial issue is, whether this obvious demand should be met by private or public production. In international comparison we see two different approaches: In the Anglo-Saxon world these developments form one of the driving forces in the development of the private service sector. In continental European welfare states these developments have resulted in an increase of the public service sector.

Both approaches to providing social services have costs and benefits: The US approach obviously allows for a rapid expansion of sophisticated service sectors (compare Table 2), but leads to a very uneven social distribution of these services. The "European" approach enables a more general distribution (and thus also generally higher levels of health, education standards, etc.) but means higher shares of taxation. The most problematic constellation may be one, which is presently experienced in some European countries: Insisting on public provision of "social infrastructure", but being unable or unwilling to finance the corresponding expenditures, results in a situation where the substantial potential for employment-growth in these sectors cannot be exploited. "Europe" is thus on a cross-roads: Either one has to be prepared to agree on high levels of public financing or one has to allow for higher shares of private production of "social infrastructure". The present combination of public production but insufficient public financing tends to be the worst of both worlds.

Table 2 - Role and Structure of the Service Sector, 1994

(Contribution to Employment as Percent of Total Employment)

	Total Service Sector	Producer of Government Services	Community, Social and Personal Services
Germany	59,1	15,9	n.a.
Austria	63,2	21,8	5,5
Netherlands	70,4	12,7	17,1
France	69,7	28,0	7,2
Sweden	69,9	32,0	8,2
U.K.	70,2	19,4	11,8
U.S.	73,1	14,5	17,5

Source: OECD in Figures, Paris 1997

Concerning the financing side it has to be taken into account, that a large part of social infrastructure is not directly financed by taxes but via social security contributions. It is this field of social security contributions where international differences are much stronger than with regard to taxes (see Table 3). As these social security contributions are usually based on the wage-sum, they add to indirect labor costs, with potentially negative effects on employment. Policies to reduce taxes on labor, as they are advocated by EU and OECD, therefore either have to lead to a new broader tax-base or they will result in a substitution of public by private social infrastructure. A respective field of far reaching economic and social consequences is the discussion of substituting public, pay-as-you-go financed pension system by privately managed capital funds ("privatizing social security"). In Austria the political preference has been to have a rather extensive encompassing system of social infrastructure (including especially the pension and health-insurance systems) and therefore accepting shares of taxation which are above OECD-average (Table 3), but there does exist a discussion about changing this combination.

Table 3 - Structures of Taxation, 1995 (as Percent of GDP)

	Taxes on income and profits	Social security contribution	Taxes on property	Taxes on goods and services	Other taxes	Shares of taxation ¹ 1995
Australia	17,3	2,0	2,6	9,3	-	31,3
Belgium	17,6	15,4	1,1	11,8	-	45,9
Denmark	31,3	1,8	1,8	16,7	0,1	45,9
Germany	11,8	15,4	1,1	10,9	-	39,1

France	7,8	20,4	2,3	12,2	1,8	44,5
Italy	15,2	13,1	2,3	11,2	-	41,8
Japan	10,5	9,8	3,2	4,3	0,1	27,8
New Zealand	23,2	0,4	2,0	12,5	-	38,1
Netherlands	11,6	18,8	1,8	12,0	0,2	44,4
Austria	11,1	18,0	0,6	11,7	0,5	42,0
Sweden	21,6	15,5	1,4	11,7	0,0	50,2
Switzerland	12,7	13,0	2,4	6,3	-	34,4
USA	12,3	7,0	3,3	5,0	-	27,6
U.K.	13,0	6,2	3,7	12,2	0,1	35,2
EU (15)	14,6	12,8	1,8	13,2	0,2	42,5
OECD total	13,6	10,5	1,9	12,1	0,2	38,4

¹Total tax and social security contributions revenue as percent of GDP

Source: OECD, Revenue Statistics, Paris 1996

8. Conclusions

In the field of economic theory for some time there has been a strong bias towards privatization, based on the economics of property rights, the X-efficiency approach, the economic theory of bureaucracy and public choice theory (see e.g. Borchering et al. 1982, Vickers and Yarrow 1991).

New developments underline, however, the fact that there are not only imperfections in the public sector, but also that there exist various forms of market failures. Therefore questions of ownership cannot be discussed without reference to structures and effects of the relevant markets (Bös 1993, Wright 1994, Nowotny 1996). This had to be learned the hard way in many post-Communist countries, especially in Russia, where privatization without competitive markets only resulted in private excess profits, loss of public revenue and massive inflation (Keren 1990). With regard to Western economies too, any discussion of the results of privatization cannot be reduced to observing cash flows, employment records and stock-exchange ratings of the enterprises concerned. From a general economic point of view, macro-economic aspects (e.g. investment behavior) and aspects relating to income distribution have also to be considered.

The privatization measures adopted to date in Austria have mainly been successful. This is due in no small measure to the fact that care was taken to ensure that privatization led, not to a restriction, but to an enlargement of the independent room for maneuver of the enterprises involved. In Austria both economists and politicians have shown a greater tendency to follow a more general, non-ideological approach with respect to privatization issues, have tried to avoid errors observed in other countries, and have reflected the special situation of Austria as a small, open, social-market economy.

Appendix. Privatization checklist, as used by ÖIAG-holding company in preparing for privatization projects

1. OVERVIEW OF THE PROPERTY TO BE PRIVATIZED

1.1. Description of the enterprise

- 1.1.1. Registered office and business areas
- 1.1.2. Ownership structure
- 1.1.3. Personnel structure

1.2. Position of the enterprise

- 1.2.1. Most important competitors
- 1.2.2. Market position
- 1.2.3. Importance, as regards location
- 1.2.4. Importance as regards Austrian synergies
 - 1.2.4.1. Austrian suppliers
 - 1.2A.2. Austrian cooperation partners/customers
 - 1.2A.3. Net output per employee and according to turnover

1.3. Enterprise data

- 1.3.1. Enterprise data for the last three to five years
- 1.3.2. Business results since last reporting date
- 1.3.3. Operating plan for next three years

1.4. Presentation regarding price

- 1.4.1. Expert opinion on valuation
- 1.4.2. Liquidation value

2. INTENDED TYPES OF SALE AND REASONS

- 2.1. Strategic buyer
- 2.2. Institutional investors
- 2.3. Stock exchange
- 2.4. Management buyout
- 2.5. Employees' holding
- 2.6. Stock swap

3. TEXT OF CONTRACT WITH DIVESTMENT CONSULTANT

4. OVERVIEW OF POTENTIAL BUYERS (potential buyers in the final selection)

4.1. Description of potential buyer

- 4.1.1. Key data
- 4.1.2. Registered office and business areas
- 4.1.3. Ownership structure
- 4.1.4. Major holdings
- 4.1.5. Acquisition and sale of holdings during the last three years

4.2. Buyer's position

- 4.2.1. Major competitors
- 4.2.2. Market position
- 4.2.3. Financial situation
- 4.2.4. Strategic objectives
- 4.2.5. Financial target figures

4.3. Reasons for acquisition

- 4.3.1. Strategic aspects
- 4.3.2. Financial advantages

4.4. Takeover concept

- 4.4.1. Acquisition objectives
- 4.4.2. Amount of holding sought
- 4.4.3. Presentation regarding purchase price
- 4.4.4. Financing of purchase price
- 4.4.5. Planned takeover date
- 4.4.6. Objectives and job-maintenance measures (three years)
- 4.4.7. Planned investment relating to continuation of the firm and modernization
- 4.4.8. Research and development strategy
- 4.4.9. Planned organizational integration of the holding

5. COMPATIBILITY WITH AUSTRIAN INTERESTS

- 5.1. Market skills will be maintained/improved
- 5.2. Know-how potential will be maintained/improved
- 5.3. Probability of continuation of firm/its further development
- 5.4. Impact on Austrian suppliers and customers

6. IMPACT ON REMAINING MEMBERS OF THE GROUP

- 6.1. Remaining risks
- 6.2. Impact of the divesting company or group on individual and group balance sheets

7. ALTERNATIVE OPTIONS

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