Privatization against the European Social Model

A Critique of European Policies and Proposals for Alternatives

Edited by
Marica Frangakis, Christoph Hermann, Jörg Huffschmid and Károly Lóránt

Privatisation against the European Social Model

This page intentionally left blank

Privatisation against the European Social Model

A Critique of European Policies and Proposals for Alternatives

Edited By

Marica Frangakis

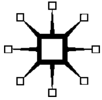
Christoph Hermann

Jörg Huffschmid

and

Károly Lóránt

palgrave
macmillan



Selection and editorial content © Marica Frangakis, Christoph Hermann, Jörg Huffschmid and Károly Lóránt 2009
Individual chapters © contributors 2009
Softcover reprint of the hardcover 1st edition 2009 978-0-230-22409-4

All rights reserved. No reproduction, copy or transmission of this publication may be made without written permission.

No portion of this publication may be reproduced, copied or transmitted save with written permission or in accordance with the provisions of the Copyright, Designs and Patents Act 1988, or under the terms of any licence permitting limited copying issued by the Copyright Licensing Agency, Saffron House, 6-10 Kirby Street, London EC1N 8TS.

Any person who does any unauthorized act in relation to this publication may be liable to criminal prosecution and civil claims for damages.

The authors have asserted their rights to be identified as the authors of this work in accordance with the Copyright, Designs and Patents Act 1988.

First published 2009 by
PALGRAVE MACMILLAN

Palgrave Macmillan in the UK is an imprint of Macmillan Publishers Limited, registered in England, company number 785998, of Houndmills, Basingstoke, Hampshire RG21 6XS.

Palgrave Macmillan in the US is a division of St Martin's Press LLC, 175 Fifth Avenue, New York, NY 10010.

Palgrave Macmillan is the global academic imprint of the above companies and has companies and representatives throughout the world.

Palgrave® and Macmillan® are registered trademarks in the United States, the United Kingdom, Europe and other countries.

ISBN 978-1-349-30898-9 ISBN 978-0-230-25068-0 (eBook)
DOI 10.1057/9780230250680

This book is printed on paper suitable for recycling and made from fully managed and sustained forest sources. Logging, pulping and manufacturing processes are expected to conform to the environmental regulations of the country of origin.

A catalogue record for this book is available from the British Library.

A catalog record for this book is available from the Library of Congress.

10 9 8 7 6 5 4 3 2 1
18 17 16 15 14 13 12 11 10 09

Contents

List of Tables vii

List of Figures viii

List of Boxes ix

List of Abbreviations x

Notes on Contributors xii

1 Introduction: Privatisation and the Crisis of Social Europe 1
The editors

Part I Privatisation in the EU: Process and Discussion – An Overview

2 Privatisation in Western Europe 9
Marica Frangakis and Jörg Huffschmid

3 Privatisation in the Central and East European Countries 30
Károly Lóránt

4 Finance as Driver of Privatisation 49
Jörg Huffschmid

5 Theoretical Approaches to Explaining and Understanding Privatisation 61
Malcolm Sawyer

6 The European Social Models: Contours of the Discussion 77
Christoph Hermann

Part II Case Studies

7 Privatisation in the Industrial Sector 93
Wlodzimierz Dymarski, Danes Brzica and Malcolm Sawyer

8 Liberalisation in Network Industries 112
David Flacher, Hugues Jennequin and Mehmet Ugur

9 Privatisation and Marketisation of Health Care Systems in Europe 129
Christine André and Christoph Hermann

10 Privatisation of Education — 145
Wolfgang Blaas, Elsa Hackl and Birgit Mahnkopf

11 Privatisation of Pensions — 164
Miren Etxezarreta and Mejra Festic

12 Bank Liberalisation and Privatisation — 187
Marica Frangakis, Jörg Huffschmid and Joze Mencinger

13 Privatisation Trajectories in Europe: A Cross-Sector View — 208
Marica Frangakis

Part III Perspectives

14 The Impact of Privatisation and Liberalisation of Public Services on the European Social Model — 221
Birgit Mahnkopf

15 Elements of a Progressive European Social Model — 233
Christoph Hermann

16 The Role of the Public Sector in a Progressive Construction of Europe — 245
Jörg Huffschmid and Jacques Mazier

17 Social Actors – Trade Unions and Social Movements — 256
Miren Etxezarreta and Marica Frangakis

Index — 267

Tables

2.1 Institutional investors in EU25, the Eurozone and in selected countries, 2006 — 19
2.2 Banks in the CEEs — 19
3.1 Dominant privatisation methods — 32
3.2 Foreign Direct Investment stocks as per cent of the GDP — 40
3.3 Balance of payments and general government deficit of the CEE countries — 41
3.4 Unemployment rates (total unemployment) — 43
3.5 Harmonised long-term unemployment and activity rate (2007) — 44
4.1 Sources of global assets under conventional management, end of 2007 — 52
4.2 PEF in privatisations in 2006 — 55
7.1 Changes of industry share in GDP in CEE EU member countries during transition process — 97
7.2 Change of industry share in total employment in CEE EU member countries during transition process — 98
7.3 Size of public enterprises in Western Europe, 1982–1991 — 104
7.4 Size of public enterprises in Western Europe, 1998 — 105
9.1 Health care systems: Spending and financing — 132
10.1 Proportion of public and private expenditure on educational institutions as a percentage, by the level of education (2005) — 150
10.2 Percentages of students in tertiary institutions by type of institution (2006) — 152
11.1 The different types of pension schemes — 172
11.2 Share of expenditure for pensions in % of GDP (current prices) — 175
11.3 Average annual growth rate per capita of spending for pensions, at constant price, in % — 177
11.4 Pensions in the new member states — 180
12.1 Bank privatisations in non-OECD, OECD and EU countries 1982–2000 — 196
12.2 Number and size of privatisation in the EU banking sector, 1982–2000 — 197
12.3 Characteristics of the CEE banking systems in 2006 — 202
12.4 Major foreign banks in the CEE banking sector — 202
17.1 Union membership and density in the EU and selected countries — 258

Figures

2.1	Privatisation proceeds (US $ million)	14
2.2	Major EU privatiser countries 1977–2007 (US $ billion)	15
2.3	Privatisation proceeds as % of GDP 1990–2005 (unweighted average)	16
2.4	Percentage sectoral share in EU15 privatisation revenues 1977–2006 (%)	17
3.1	Real GDP levels in the new EU member countries 1988 = 100	38
3.2	GINI index for per capita incomes from 'official' sources	45
12.1	Bank privatisations in the EU15, 1985–2007	194
12.2	Bank privatisations in the EU15 countries, 1985–2007	195
12.3	Share of public ownership in bank assets	199
12.4	Bank privatisations in the CEE members of the EU, 1992–2004	201

Boxes

2.1 The East German privatisation experience 12
2.2 About PPPs 20
2.3 The European Commission on social services 26

Abbreviations

CEECs	Central and East European Countries
CEU	Council of the European Union
CITUM	Confederation of Independent Trade Unions of Montenegro
DB	Defined Benefit
DC	Defined Contribution
DHAs	District Health Authorities
DM	Deutsche Mark
DRG	Diagnosis Related Groups
EBRD	European Bank for Reconstruction and Development
EC	European Commission
ECB	European Central Bank
ECJ	European Court of Justice
ECOFIN	Economic and Financial Council
ECT	European Communities Treaty
EEC	European Economic Community
EHEA	European Higher Education Area
EIB	European Investment Bank
EMU	European Monetary Union
EPL	Employment Protection Legislation
ESF	European Social Forum
ESM	European Social Model
EU	European Union
EUT	European Union Treaty
FDI	Foreign Direct Investment
FSAP	Financial Services Action Plan
GATS	General Agreement on Trade in Services
GDP	Gross Domestic Product
GPFH	General Practitioners Fundholders
HNWI	High Net Worth Individuals
IMF	International Monetary Fund
IORP	Institutions for Occupational Retirement Provision
IPO	Initial Public Offering
MEBO	Management and Employee Buy-Out
NGO	Non-Governmental Organisations
NHS	National Health System
NMS	New Member States
NPM	New Public Management
NRAs	National Regulatory Authorities
NUM	National Union of Mineworkers

OECD	Organisation for Economic Cooperation and Development
OMC	Open Method of Coordination
PAYG	Pay As You Go
PbR	Payments by Result
PCS	Public and Commercial Services Union
PEF	Private Equity Fund
PFI	Private Finance Initiative
PPPs	Public Private Partnerships
PRESOM	Privatisation and the European Social Model
ROR	Rate of Return
SEA	Single European Act
SGEI	Services of General Economic Interest
SGI	Services of General Interest
SMEs	Small and Medium Size Enterprises
TFP	Total Factor Productivity
TU	Trade Unions
TUC	Trade Union Congress
VPFs	Voucher Privatisation Funds
WB	World Bank
WFS	World Financial Stocks
WSF	World Social Forum
WTO	World Trade Organisation

Notes on Contributors

Christine André is Senior Researcher at CNRS, Paris School of Economics. She is also researcher at CEPREMAP (Paris). Her research interests are in international comparisons of the evolutions of the social state, of health care systems and of pension systems in Western Europe in the long run, and in patterns of state-economy relationships since the nineteenth century.

Wolfgang Blaas is Associate Professor of Economics, Vienna University of Technology, Austria. He is the author of 7 books, has edited 7 books and published 50 papers and he was involved in 36 research projects. His research interests are in macroeconomics, international economics, regional and urban economics and in real estate economics.

Danes Brzica, Ph.D. in economics, head of a research unit at the Institute of Economic Research, Slovak Academy of Sciences. Research concentrates on governance, transition policies, regional and corporate competitiveness, institutional changes and technological development. Has lectured in economics at the Comenius University and acted as coordinator for economics at the School of Public Administration.

Wlodzimierz Dymarski, Ph.D. in Economics, post-doctoral studies at the University of London, Institute of Education. Tenured Senior Lecturer at the Poznan University of Economics, Department of Economic Policy. Main fields of research: economic policy and development; labour market policy, human resources management. Co-author of about a dozen books. Member of the Euromemorandum Group and member of its Steering Committee since.

Miren Etxezarreta, Ph.D. (Economics) is now Emeritus Professor of Applied Economics at the Autonomous University of Barcelona where she has been working for many years. Her main fields of interest are macroeconomic and social policy in Spain, development economics, European social policy and agricultural economics and rural development. She has published nine books and many articles in other books and journals. She coordinates a seminar in critical economics and works extensively with the social movements.

Mejra Festić, Ph.D. is Associated Professor in Economics (Macroeconomic Theory and Policy), Banking and Finance. She is employed at the Faculty of Business and Economics – University of Maribor and at the Economic Institute of the Law School (EIPF) in Ljubljana. She is a vice-rector for the field of Academic Affairs at the University in Maribor. Ph.D.: at University of

Maribor and Heinrich Heine Universität Düsseldorf. She is a member of the Association for Comparative Economic Studies (ACES), Arizona.

David Flacher is Associate Professor in Economics at Paris 13 University and member of CEPN laboratory. He is an engineer in Telecommunications of ENST (Télécom ParisTech) and Dr. in Economics of Paris 9 – Dauphine University. His research work deals with regulation of network industries and with economics of innovation.

Elsa Hackl, Department of Political Science of Vienna University. Master Degree in Law, Doctor Degree in Politics. Has worked as a civil servant in a senior position (director at the Austrian Ministry for Higher Education and Research), was Visiting Fellow at the University of British Columbia, Canada and at the European University Institute, Florence, worked as an expert for OECD, the Council of Europe and Salzburg Seminar. Member of the OECD/CERI Governing Board. Research topics: Education policy, Europeanisation/internationalization, public administration.

Hugues Jennequin is Associate Professor at the Rouen University (Rouen, France). He is a member of the CARE laboratory (Centre d'Analyse et de Recherche en Economies) and reports the 'services economics and regions' working group in a Department of the Prime Minister at the Ministry of ecology, sustainable development and sustainable planning, responsible for preparing and implementing the guidelines of national land planning policy (DIACT). His research deals with the services location, especially the Knowledge Intensive Business Services and telecommunications. He wrote a book with David Flacher called *Réguler le secteur des télécommunications? Enjeux et Perspectives*, Economica Editions, 2007.

Birgit Mahnkopf is Professor of European Politics at the Berlin School of Economics and Law (Hochschule für Wirtschaft und Recht Berlin, HWR Berlin); diploma, Ph.D. and post-doctoral degree (habilitation) in social sciences at the Free University Berlin. Areas of expertise are: international political economy; globalisation and governance; industrial relations and sociology of work. Her published work includes more than a hundred articles in books and journals and 12 books.

Jacques Mazier is Professor of Economics, Paris North, specialised in macroeconomics, international economics and macro-modelling. After working for the French government as researcher and advisor and after heading the Institute de Recherche Economique et Sociale (IRES) in Paris he took up the position as a professor at the University of Paris North. He has edited and contributed to a number of books in French and English and has widely published in French and English economic journals.

Joze Mencinger, Ph.D. in economics with the University of Pennsylvania, Philadelphia, USA; Professor of Economics, Law School, University of Ljubljana; author of a number of articles and publications; author and co-author of a number of econometric models; deputy prime minister and minister for economic affairs: Republic of Slovenia; member of the Board, Bank of Slovenia; rector of the University of Ljubljana; member of the State Council, Republic of Slovenia; editor of a monthly GOSPODARSKA GIBANJA dealing with current macroeconomic issues and short-run predictions.

Malcolm Sawyer is Professor of Economics, University of Leeds, UK. He is managing editor of *International Review of Applied Economics* and the editor of the series *New Directions in Modern Economics* published by Edward Elgar. He is the author of 11 books, has edited 24 books and published 90 papers in refereed journals and contributed chapters to over 100 books. His research interests are in macroeconomics, fiscal and monetary policy, the political economy of the European Monetary Union, nature of money, causes and concepts of unemployment and the economics of Michal Kalecki.

Mehmet Ugur is Jean Monnet Reader in European Political Economy at the University of Greenwich Business School. His research focuses on economic governance, regulatory quality, EU conditionality and EU-Turkey relations, and corporate governance. His publications include several books. Currently, he is working on liberalisation and regulatory quality in European network industries.

1
Introduction: Privatisation and the Crisis of Social Europe

The editors

The central themes of this book are the processes of liberalisation and privatisation and their consequences for economic development, social cohesion and political democracy in the European Union. The worldwide financial meltdown following the sub-prime mortgage crisis in the United States has fundamentally called into question the established pattern of globalisation and the dominant neo-liberal framework of economic governance and policy which was gradually set up in more and more parts of the world since the late 1970s. During the last few years it has become increasingly clear that the policies of liberalisation and opening up more areas to the market, of deregulation and privatisation, and of establishing the rule of competition as the overarching point of reference for economic and social reproduction have not fulfilled the promises and expectations which accompanied their introduction. Instead, they have unleashed destructive dynamics in two directions. On the one hand, they have contributed to the enormous social polarisation and growing inequality throughout the world and in almost every single society. On the other hand, the liberalisation of capital movements and the creation of global capital markets have not reduced but exacerbated the inherent instability of the capitalist mode of production.

This has, of course, strong consequences for the content and development of the so-called European Social Model (ESM). 'So-called' because there is widespread consensus that there is no such thing as *the* European Social Model as a clearly defined entity, but that there is a range of social models in European countries, and that this diversity should not be regarded as a burden but as an asset to Europe and European history and culture. Nevertheless, there are certain political and social elements in each of these models which together form the normative cornerstones of a specific European framework of social and political cohesion. Such basic elements include a relatively strong sense of social solidarity instead of competitive individualism, and a positive role for the state, which should bear responsibility for the welfare of individuals. As a reflection of this role, most European societies were,

throughout most of the past century, characterised by the existence of a strong public sector, as part of a 'mixed economy', and of social cohesion as well as of a public cultural and political space. Whereas, in the private sector, the rules of competition and profit dominate, the public sector is meant to be shaped and structured through public discussion of, and decisions on, the provision of goods and services to all members of society regardless of their income and social status. This is, of course, a much more complex qualitative structure than the one imposed by the rule of competition and the quest for quantitative profits.

The neo-liberal counter-revolution, which has developed during the last 30 to 35 years, has severely attacked this co-existence of the private and the public sector. The Magna Carta of such attacks was the so-called 'Washington consensus and its main institutional spearheads – the International Monetary Fund (IMF), the World Bank (WB), and the World Trade Organisation (WTO), and, particularly with regard to public services, the 'General Agreement on Trade in Services (GATS). As a result of these attacks, the balance between the competition-oriented and the welfare-oriented pillars of societal development has been shaken and shifted in favour of the former. The number and weight of publicly owned corporations have shrunk considerably, and the remaining state-owned corporations – and growing parts of public services – are increasingly reshaped according to the logic and rules of markets and competition. In this context, it should be emphasised that the concept of privatisation covers a much broader scope than just the change of ownership from state or otherwise public to private ownership – although the latter plays a crucial role. This is particularly true with regard to services: the transformation from public to private services occurs in very different forms and degrees, which are not always tightly linked to specific ownership categories. Privatisation of public services in this sense means the transfer of a service from the framework of a politically determined public good to a framework of privately provided commodities. Whereas the criterion for the 'efficiency' of public services is the fulfilment of a politically and socially defined more or less complex task or mission, efficiency of private services is measured in the amount or rate of profits which they generate for their providers. Privatisation can already start in state-owned enterprises, through corporatisation of former departments of ministries, outsourcing and other forms of enhancing cost efficiency of a service provided by the state. Privatisation can relate to different aspects of a public service, for example in terms of who supplies the service (public or private), who pays for it (state or individual) and whether some forms of market mechanism are used in the provision of the service.

Because of these developments, the tendency has emerged to transform the variety of different European social models into one uniform neo-liberal pattern corresponding to the interests and benchmarks of international financial investors. The 'European model of society' often invoked by the

proponents of privatisation is that of superior competitiveness as a consequence of liberalisation. The social model is seen as universal commercialisation in which the whole world is seen as an accumulation of commodities and individual and social activities appear as transactions, concealing the underlying structures of inequality, power and ever enhanced exploitation of the majority of people through a small but powerful minority.

In the course of the work on these issues, it has become increasingly clear that the European Union (EU) has played and continues to play a special role in this process of neo-liberalisation of the world. While in the first decades after World War II the European Economic Community (EEC) and the European Communities (EC) did not play an active role in the formation of neo-liberalism, this has changed since the mid-1980s. The adoption of the Single Market project in 1985, the Treaty of Maastricht (1992), the Stability and Growth Pact (1997), the Financial Services Action Plan (FSAP, 1999) and the Lisbon Strategy of 2000 and 2005 are all decisive moves towards the reshaping of the European construction and the establishment of a neo-liberal zone of liberalisation and privatisation. This process has been partly modified and partly been accelerated by the accession of the new member countries from Central and Eastern Europe since 2004. For these new members, liberalisation and privatisation were cornerstones of a comprehensive economic and political transformation following within a very short time-span the collapse of the previous system of state socialism. Although the EU has no legislative competence in terms of public or private ownership, its policies of liberalisation and marketisation work as a powerful propulsion engine for privatisation in the comprehensive sense outlined above. Today the thesis appears not exaggerated that the EU has taken over from the WTO and particularly from the GATS the role of the avant-garde and driving force of further liberalisation and privatisation.

However, this process of commodification of the world unfolds neither in a straightforward way nor does it remain unchallenged. Two countervailing factors must be noted here. The first one is the increasing vulnerability and internal instability of a finance-driven development which includes strong tendencies for speculations and the build-up of ever larger bubbles. These destabilising forces have exploded in the recent world financial crisis and this has brought the question of alternatives to a world ruled by markets and competition back to the theoretical and political agenda. The second factor is the growing dissatisfaction, critique and resistance against the policies of liberalisation and privatisation, reflected in the struggle of many trade unions as well as in the rising number of social movements – mostly on the local, but also on the regional and occasionally on the national level – against the further privatisation of public goods like water or public services like health care. In some cases privatisation has been prevented through resistance by the population, in others privatised services have been renationalised. Even the recent partial nationalisations of the financial sector as a

rescue package against the financial crisis – although they certainly do not indicate the revitalisation or a new form of modern welfare state – clearly demonstrate that markets and competition cannot work as framework for economic and social development but need a framework of political rules and interventions within which they can generate positive dynamics and beneficial effects. In this sense, the official responses to the financial crisis confirm the theoretical critique and political resentment against a policy of unlimited liberalisation and privatisation of the world.

The present book is the result of the network 'Liberalisation and Privatisation and the European Social Model' (PRESOM). Sixteen members from 12 EU countries participated in this network, which was financed by the EU as a 'Coordination-Action' (CA) within the Sixth Framework Programme for Research and Development. During its lifetime (January 2006 – April 2009), the network organized approximately 50 workshops with numerous external experts from the scientific community, as well as policymakers and civil society groups. The main thrust of the CA was – in spite of differing scientific and political positions and assessments amongst the participants – a critical approach to the dominant discourse and policies of liberalisation, privatisation and the far-reaching destruction and/or deformation of the public sector in the EU. Although critiques of the structure, performance and behaviour of the traditional public sector in the post-war period are in many cases justified and there is no simple way back to past structures, it is one of the common beliefs of the authors – and one of the main results of PRESOM – that there is a need for a strong and democratic public sector in order to maintain, revitalise and strengthen the cornerstones of a European Social Model which improves the social welfare and political democracy for the people in Europe.

The book is structured in three parts:

The *first part* gives an *overview* of the issues at stake. It summarises the process and various aspects – motives, drivers, proceeds – of *privatisation in Western Europe* (Chapter 2) and in the *new member states* (Chapter 3). In this context, special attention is given to *finance* as an important driver of privatisation (Chapter 4). In Chapter 5, main *theoretical approaches* to the question of private and public ownership are addressed and critically examined. Chapter 6 presents the different streams and connotations in the past and current discussion about the content and function of the *concept of the European Social Model*.

The *second part* contains six *case studies* on privatisation in Europe. While privatisation in *manufacturing* (Chapter 7) has only affected small parts of the Western European economies, it was the main process of transformation in the CEECs, and therefore particular emphasis is put on the new members. *Network services* (telecommunication, energy, Chapter 8) were the main targets for liberalisation and privatisation in the EU15 during the 1990s, and a review of the results shows that the promises and expectations which accompanied this process remain far from justified. A particularly complex

structure can be observed in the *health care sector* (Chapter 9) where very different forms of liberalisation and privatisation coexist, and the development of diverse connections between the public and private sectors, together with an increasing role of the private sector, are the two main trends. The chapter on *pensions* (Chapter 10) contains more straightforward arguments and results: the increasing threat of old age poverty through the shift from public PAYG systems towards private capital funded systems. *Education* (Chapter 11) is again one of the areas where privatisation is a complex process which occurs to a considerable extent within state-provided systems. In the area of *finance* (Chapter 12), the privatisation has resulted (with very rare exceptions) in the virtual absence of any relevant state-owned bank in almost all EU members, and this has deprived the state of an important instrument to counter the financial crisis. Chapter 13 summarises this part and tries to draw a *differentiated and coherent picture* of the process of privatisation in Europe in the last three decades.

The *third part* deals with *perspectives and alternatives*. First, the mostly problematic *impact of liberalisation and privatisation* on the economy, social cohesion and political democracy, and thus upon the common cornerstones of the European Social Model in the traditional sense, are presented (Chapter 14). As an alternative profile, Chapter 15 establishes a number of *positive elements* which a progressive ESM would require, and Chapter 16 discusses the *role of a renewed and reshaped public sector* for economic development, social cohesion and political democracy in a progressive ESM. Finally, Chapter 17 deals with the *forces and actors* which are required and capable of achieving a turnaround from the still dominant neo-liberal pattern of development in the EU towards a progressive alternative.

The editors want to express their sincere thanks and appreciation to Dr. Jacqueline Runje who accompanied PRESOM as managerial assistant. Without her patient and persistent work it would have been much more difficult to keep the project together and to organise the work for PRESOM book.

Part I

Privatisation in the EU: Process and Discussion – An Overview

2
Privatisation in Western Europe

Marica Frangakis and Jörg Huffschmid

2.1 Introduction

This chapter consists of two parts, (1) presenting an overview of privatisation in Western Europe, and (2) going more deeply into the role of EU policy in promoting privatisation. Our approach is based on the notion that by the time privatisation picked up as an explicit component of the neo-liberal project, most Western European states were already members of the EU and a certain convergence ensued in terms of policy orientation and prevailing ideology. Even though the EU does not take a direct stand in favour of the sale of state property, its role in this process should not be underestimated. Accordingly, Part 2.1 below presents an overview, while Part 2.2, deals with the role of EU policy.

2.2 An overview

2.2.1 Defining privatization

Privatisation is a capsule word. Although it clearly denotes some kind of transformation from the public to the private sphere, the actual form it takes varies from era to era. Thus, the change in the pattern of ownership from public to private is its most basic form. However, like a chameleon, it may take other forms. Hence, describing privatisation may lead to limitations *across time* – what was obvious in the 1980s became much more subtle in the 1990s and beyond; *across sectors* – what may be observed in the utilities does not necessarily correspond to what is happening in the public services; and *across regions* – what happened in the Central and Eastern European economies was quite unique.

Overcoming such limitations leads us to a comprehensive approach that focuses on the process of market liberalisation, whereby privatisation is embedded in the neo-liberal project, that is, the market-driven reforms of the past 30 years. In this sense, privatisation is a means of commodification. Thus, for a public good or service to be subjected to market practices and to

be privatised, it has to be treated as a commodity, for example as a "scarce, monetised entity subject to the same laws and principles of the market as shoes, lampshades or computers" (McDonald and Ruiters, 2005, p. 13). Seen in this light, privatisation becomes a moment, a stage in the evolution of capitalism. It represents a shift in the relations between the state, the society and the economy which is a pervasive process in political, social and economic terms.

In the following sections of Part 2.2, we shall review the rationale (2.2.2); the timing and phases (2.2.3); the revenues (2.2.4); the sectors (2.2.5); and the forms of privatisation and the role of business interests in Western European countries (2.2.6).

2.2.2 The rationale of privatization

In the twentieth century, Western European countries witnessed a succession of nationalisation waves, closely linked to the economic, social and political conditions prevalent at the time. The first such wave was related to the Great Depression of 1929–1930, the length and intensity of which led to the abandonment of traditional, liberal policies and to the adoption of government interventionism in the industrial as well as financial sector. The second wave followed the termination of World War II and it was spurred on by the need to reconstruct the economy of practically the whole of Europe. The third wave occurred after the oil shocks in the 1970s and in view of the increasing competition from Japan and other Asian countries, with the express aim of rescuing ailing firms and thus sustaining economic growth and employment.[1]

As a result, in the late 1970s, state-owned enterprises in Western European countries accounted for a significant share of economic activity, estimated at about 10 per cent, as opposed to 7 per cent in the non-European OECD countries. However, with the onset of the 1980s and the Reagan and Thatcher eras in the US and UK respectively, the dogma of privatisation and market deregulation took hold of both politics and economics, spreading to the rest of the world at a remarkably fast pace.

The member states of the European Union readily adopted the policy of privatisation in the pursuit of a multiplicity of objectives. These included (1) promoting efficiency, on the axiomatic assumption that "private companies tend to be more efficient that public ones", or, more elegantly, that "public ownership is ... considered to reduce incentives for efficient resource allocation, both in terms of improvements in internal efficiency (cost-minimization) and allocative efficiency (pricing according to marginal cost)" (Morano, 2005, p. 2 and OECD, 1995, p. 40, respectively); (2) increasing competition in particular sectors and in the economy at large; (3) developing a national capital market; (4) reducing the public debt, as well as the public deficit, especially in view of the adoption of the single currency; and (5) last but not least, promoting a culture of equity ownership amongst the population in general. In terms of the EU decision-making process, given

the official policy agenda, lobbying further influenced privatisation policy and its rationale.

More generally, decision-making in the EU institutions is notorious for its lack of transparency. Important matters are often discussed in obscure committees, where industry representatives are usually present, as opposed to representatives of labour unions, consumers and other such interest groups, which are conspicuous by their absence. Decisions are made on an intergovernmental basis, with the European, as well as the national parliaments, playing a minor, if any role, while the wider public remains uninformed.

In this way, special business interests find their way to the seat of power in EU politics and employ various means to influence decision-making in their favour. In this respect, the role of the media and their close connections with large corporations should not be underestimated. Although a direct link between privatisations and the EU decision-making process is by definition difficult to establish, in view of the secrecy of such relations, the political legitimacy of the EU has suffered greatly since the 1990s, as documented by various analysts (see Etzioni, 2008).

Furthermore, the EU follows a more explicitly pro-privatisation policy in its relations with third countries and especially with the neighbouring countries of North Africa and the Middle East. For example, it tries to enforce market liberalisation through requests for publicly owned sectors and enterprises (water, electricity) to be opened up under the General Agreement on Trade in Services (GATS) process (Hall, 2005), thus paving the way for privatisation.

Overall, global pressures, as well as specifically European ones, had a part in the rationale of privatisations in the EU. Such pressures reinforced the political-ideological configuration of the time, which regarded privatisation not only as a means, but also as a goal of policy.

2.2.3 The timing and phases of privatisation

The actual privatisation experience across countries varied, although moving into the 1990s, the rate of privatisation became more synchronized. Roughly, we can distinguish three types of privatisation experience across Western Europe in terms of timing – that of a core group, exemplified here by the UK, Germany, France and Italy; that of the Nordic countries; and that of the southern European countries.

Systematic privatisation, falling within a liberalising political and ideological framework, is closely associated with the *UK* and the first Thatcher government in 1979. The fact that a conservative government was re-elected four times in a row gives the UK experience a rare continuity. Thus, by the mid-1990s, all the sectors which had been nationalised during the post-war period, as well as by the Heath government in the early 1970s, had been privatised, reducing the share of the public sector in Gross Domestic Product (GDP) from 9 per cent in 1979 to less than 3.5 per cent in 1992. The return of Labour to office in 1997 did not reverse the process of privatisation.

In *Germany*, another major privatiser, a privatisation programme was launched in the 1950s, under Chancellors Adenauer and Erhard. This lasted until the mid-1960s and resulted in about 40 privatisations, mostly of minor public entities. The first major privatisations were those of Preussag (mining company; 1959), Volkswagen (1961; the federal state kept 20 per cent and the State of Lower Saxony 20 per cent) and VEBA (1965; the federal state retained 40 per cent). In the mid-1960s, the social democrats were elected to government, interrupting the process, while the next privatisation wave occurred in the mid-1980s. Since the end of the 1990s, privatisation is mostly related to the public services.

Box 2.1 The East German privatisation experience

A separate, relatively short but very intensive third phase, albeit within the second one, was the complete privatisation of the Eastern German economy, which started in 1990 and was largely accomplished by the end of 1994.

Privatisation in East Germany was directed and supervised by the Federal Trust Agency (THA), which was established in order to oversee the transition. At the end of 1994, 7853 out of 12,000 state-owned enterprises had been fully privatised. Of these, 1600 were returned to their former owners, 261 were transferred to the municipalities and 2700 were sold to former employees or managers (MBO). Moreover, 3713 formerly state-owned firms were shut. At the end of 1994, the THA was dissolved. The cost of the transition was especially high as the THA spent over DM 300 billion, while the total privatisation revenues amounted to DM 60 billion only. At the same time, millions of jobs were lost.

Source: Huffschmid, J, 2006, Privatization in Germany, unpublished PRESOM working paper, Bremen

By contrast to the UK and Germany, state interventionism has traditionally been especially strong in *France*. The conservative government elected in 1986 introduced the first large wave of privatisations. By 1988, 1200 firms, involving 350,000 employees, had been privatized. After that time, the alternative election of socialist and conservative governments led to a 'pendulum' type of phenomenon, whereby the former tended to halt privatisation (1988–1993) and the latter to promote it (1993–1997). However, since the late 1990s such distinctions have become blurred, as both conservative and socialist governments follow a 'pragmatic approach', according to former prime minister of the Chirac government, Jean Pierre Raffarin.

In *Italy* too, state participation in the economy was especially strong in as late as the early 1990s. This is when privatisation was introduced in a systematic way, strongly accelerating in absolute and relative terms by the late 1990s. For example, the Italian privatisation revenues exceeded those of any other OECD country between 1995–1999.

The experience of the Nordic countries varies from that of the above Western European ones, insofar as there were minor ideological differences

between socialist and non-socialist parties with regard to privatisation in the 1980s. Thus in *Sweden*, a non-socialist government carried out the nationalisation of the shipyards in 1976–1982. Privatisation received a further push from the conservative Carl Bildt government in 1991–1994, promoting 'competitive ownership structures'. Similarly, in *Finland,* privatisation appeared on the political agenda in the 1980s, when the social democrats were in government. Until 1997, three major companies (Enso-Gutzeit; Valmet; Outokumpu) had been privatized, while the state became the largest shareholder (30.4 per cent) of a previously private manufacturing concern in mineral products and machinery (Partek). On the other hand, in *Denmark*, few privatisations have taken place, implying that the state continues to play a key role in the economy.

The experience of the *Southern European periphery* is also different to that of other Western European countries. In the 1970s, all three countries – Spain, Portugal and Greece – were under a dictatorship. By the end of that decade, all three had returned to democracy, often associated with the nationalisation of enterprises, of a more or less strategic importance, or simply in need of support in view of the economic turmoil of that period. By the mid-1980s, however, privatisation had become part of official policy. Accession of all three to the then European Community appears to have bolstered the move towards privatisation.

Thus, in *Spain*, a large privatisation programme was put into place in the mid-1980s by the socialist party in government. Firms which had been nationalised during the 1970s were privatized. The privatisation process accelerated rapidly after the election of a conservative government in 1996, doubling the privatisation proceeds between 1996 and 2001.

In Portugal, privatisations started relatively early, while the socialist party elected into government in 1995 increased the rate of privatisations.

In Greece, on the other hand, the first privatisations took place under a conservative government, in the early 1990s. The socialist party ruled for the next 11 years (1993–2004), further elaborating the privatisation process and lifting many of the remaining restrictions to privatisation, while official policy laid emphasis on the promotion of equity culture. The return of the conservatives to power in 2004 brought privatisations back to the centre of economic policymaking on economic efficiency grounds.

Our examination of the timing and phases of privatisation across Western European countries has been necessarily selective. Even so, certain generalisations may be made. First, privatisations appear to be part of the neo-liberal project instituted in the 1980s, although the actual starting point varies from country to country. Second, in the early period (late 1970s to late 1980s), privatisations were more closely linked to the election of conservative governments. This distinction loses its significance as we move to the 1990s, when privatisation was adopted by both socialists and conservatives as a more or less central part of their reform agenda. In this sense, privatisations became

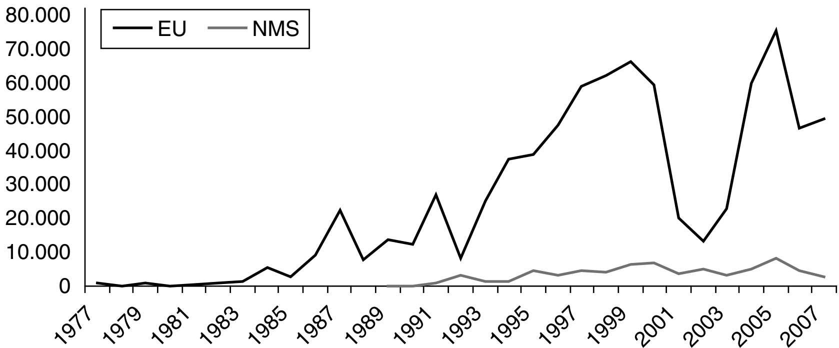


Figure 2.1 Privatisation proceeds (US $ million)

Note: 'EU' includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the UK. 'NMS' includes Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Slovenia.

Source: Privatization Barometer Databank; own calculations

not just a dogma, but also a means of serving established interest groups and power structures. Third, as the privatisation project evolved, new types emerged, quickly spreading across the various countries. Lastly, membership of the EU appears to have positively influenced the rate at which privatisations spread.

2.2.4 Privatisation revenues

The EU is the area most involved in the privatisation process globally, having implemented the greatest number of privatisations – approximately one-third of all deals – and raised about one-half of global revenues since 1977.

Figure 2.1 shows the annual amounts raised by the EU-15 and the new member states between 1977 and 2007.[2]

As we can see, in the EU-15 privatisation activity took off in the late 1980s, declined in the early 1990s due to the trough of the period, and then rose to spectacular levels in the mid- to late 1990s, feeding, as well as taking advantage of, the stock market bubble of the time. The burst of the dotcom bubble in the early 2000s was reflected in a significantly reduced volume of privatisation proceeds, while privatisation activity resumed its upward trend in the mid-2000s. In fact, 2005 has been described as "a record year in recent privatisation history" (PB Newsletter No. 4, p. 6). This record is largely attributable to the results of a single country, France, which raised almost half of total proceeds, implemented the largest Initial Public Offering (IPO) (Electricite de France), the largest secondary accelerated sale (France Telecom) and three out of the four largest private sales via the complete divestiture of the highway sector.

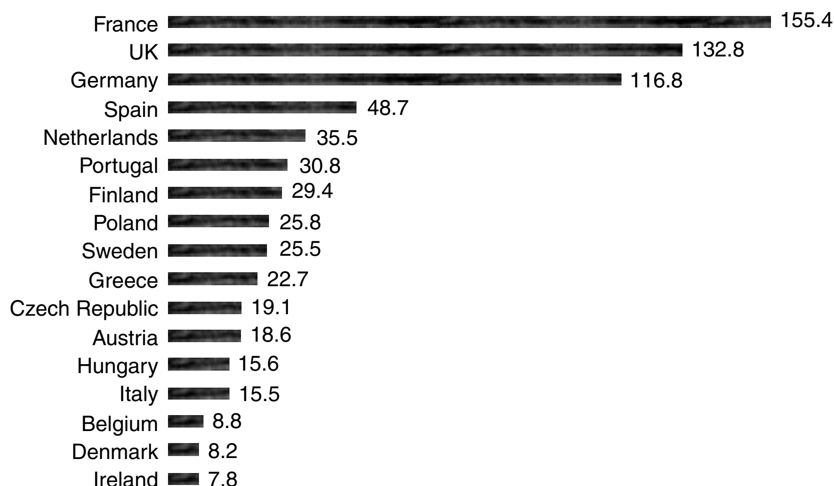


Figure 2.2 Major EU privatiser countries 1977–2007 (US $ billion)
Source: Privatization Barometer Databank; own calculations

Over the period 1977–2007 the privatisation revenues of the member states of EU-15 amounted to US $796,517 million, while those of the New Member States (NMS) (as defined in Figure 2.1) to US $69,195 million. In absolute terms, the top three privatiser countries were France, the UK and Germany (Figure 2.2).

However, the order changes in relative terms. Figure 2.3 provides a rough indication of the size of privatisation proceeds in relation to GDP over the period 1990–2005, a period during which a major privatisation drive took place. As we can see, the revenue from privatisations was much more significant in relation to GDP in the smaller EU economies than in the larger ones, while the Czech Republic, a new member state, heads the list.

2.2.5 Privatisation across sectors

Practically all sectors of economic activity feature in the privatisation experience of the member states of the EU, albeit with variations as to the extent of the sector being privatised, the chronological order, the proceeds and the regulation of the sector following its liberalisation and privatisation. In particular, the privatisation of state enterprises in the manufacturing sector, which in many cases preceded the privatisation drive of the 1990s, occurring in early privatisers such as the UK and Germany, presents the greatest variations. It mostly concerned the cement and steel industries and shipyards.

On the other hand, the privatisation of the infrastructure and network industries – transport, telecommunications, energy – which started in the

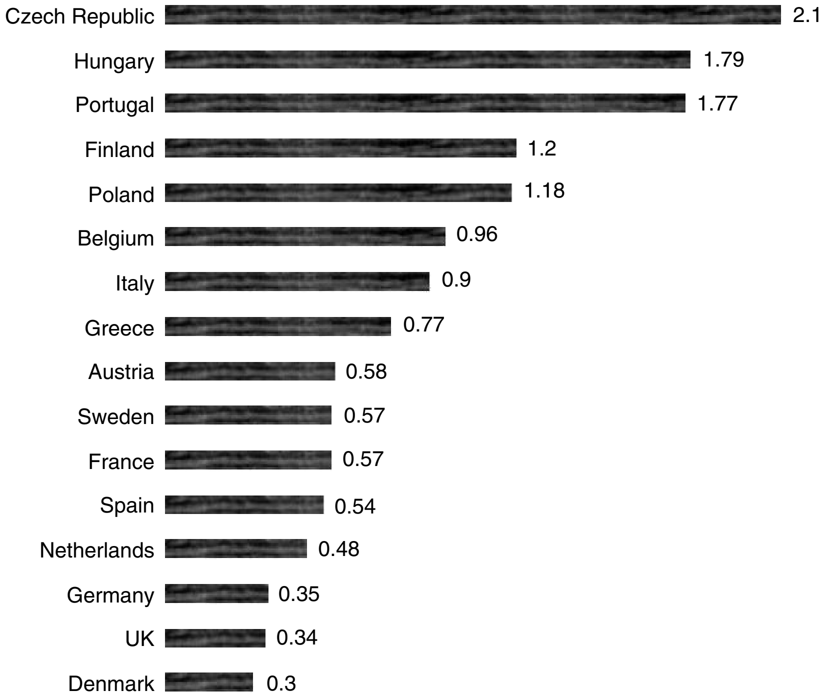


Figure 2.3 Privatisation proceeds as % of GDP 1990–2005 (unweighted average)
Source: Privatization Barometer and OECD Databank; own calculations

mid-1980s and is still ongoing appears to follow a more or less similar pattern across regions. These industries were considered to be ideal candidates for privatisation, given that they were mostly outside the sphere of international competition. The more oligopolistic the structure of any particular sector, the more it attracted the attention of private investors.

In particular, the telecommunications sector dominated privatisation, both on the European and global level. This was largely due to the rapid pace of technological progress and the introduction of new products and structures, lowering the costs of entry, as well as the liberalisation of the sector by government policy. In fact, the extensive and early sale of telecom assets was said to serve as "a flagship sale of public utility assets" (OECD, 2003, p. 30). As a result, telecommunications companies have been partially or fully privatised in most European countries over the past 25 years.

The financial services sector has also undergone extensive privatisation. In the UK mutual building societies and mutual life insurers were de-mutualised throughout the 1990s, while in France, the financial and banking sectors were heavily privatised. This was further the case in Italy

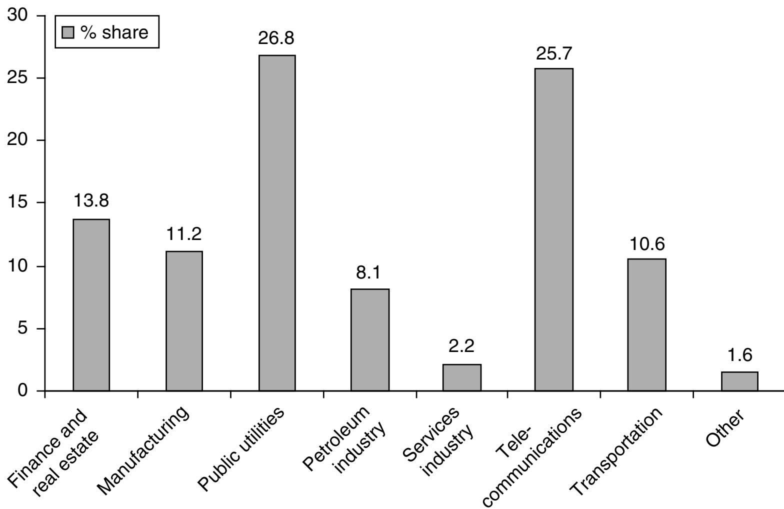


Figure 2.4 Percentage sectoral share in EU15 privatisation revenues 1977–2006 (%)

Note: 'EU' includes Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden and the UK.

Source: Privatization Barometer Databank; own calculations

and in the southern European states. Generally, the share of public institutions in the financial sector and especially in banking was drastically reduced across the Western European countries.

Other sectors exposed to the privatisation mania of Western European governments include housing (e.g., in Germany and the UK), the prisons and the military services (UK), new technology enterprises (Denmark), the postal services (Germany), and so on. More recently, privatisation is spreading to the public services sector, which for the most part still remains in public hands (Figure 2.4).

2.2.6 Forms of privatisation and business interests

Two important elements of the rationale for privatisations were (1) to promote an 'equity culture' and (2) to boost the capital market. Initially, privatisation policy was sold to the wider public as a way of creating what came to be called 'popular capitalism' or 'capitalism for the masses'. The target group of investors was the retail investor. To this end, the sellers, that is governments, often provided incentives in order to attract individual investors to join the privatisation process.

For example, the Thatcher government's privatisation programme, especially in the initial term, emphasised the declared objective of expanding and spreading equity ownership. This was achieved through a massive

programme of share issue privatisations characterized by substantial underpricing, tax incentives, and so on (Bortolotti, 2005). As a result, the percentage of shares held by private individuals rose from 7 per cent to 25 per cent although it fell back to 20 per cent at a later stage.

The same pattern of temporarily rising equity ownership by retail investors in the initial stages of the privatisation process has been observed in other European countries, too. Thus, in France there were 1.3 million retail investors in 1978. By 1987, after tax incentives were given to participate in public offerings, their number had increased to 6.2 million, falling thereafter. In Germany, the share of the adult population owning shares (directly or indirectly through investment funds) never rose above 20 per cent, while it has considerably fallen in the past few years. In Spain, the public largely participated in the early stages of the privatisation process.

Indeed, it has been shown that the initial structure of shareholding does not appear to be stable over the long run, as the majority of initial investors tend to dispose of their holdings to cash the initial discount. The majority of shares end up eventually with the financial institutions (Boutchkova and Megginson, 2000).

The goal of spreading equity ownership further served a more strategic one, that of stimulating the development of the capital market by providing profitable opportunities. As the share of retail investors declined, that of the institutional investors increased, where these include insurance companies, pension funds and investment funds. As shown in Table 2.1, in 2006, before the start of the financial crisis, the funds under management by institutional investors exceeded GDP both in the EU25 and in the Eurozone on average, while in certain cases – UK, Netherlands – they were significantly greater than GDP, thus indicating the growing significance of the financial system in the economy as a whole.

Other financial institutions acquiring a significant stake in the financial system and in the economy of the European states through the privatisation process include the banks and especially Western European banks taking over large chunks of the banking sector of Eastern and Central European states. Such deals were often carried out outside the capital market, which was underdeveloped in the Central and Eastern European countries. As a result, the banking sector of the Central and East European Countries (CEEs) is today largely foreign owned (Table 2.2).[3]

More recently, as the privatisation process matured – that is, the stock of state-owned assets becomes depleted – new forms of privatisation, such as the Private Public Partnerships, have appeared and are gaining ground, especially in the core Western European countries.

In the case of public services, the notion of the market has been introduced in a variety of ways under the general label of 'reforms', promoted by the so-called New Public Management of public services. This term was coined by the Thatcher and Major conservative governments in the UK between

Table 2.1 Institutional investors in EU25, the Eurozone and in selected countries, 2006

	Total	Pension funds	Insurance companies	Investment funds
UK (€ million)	6,133,617	2,351,452	3,173,492	608,673
% GDP	321.8			
France (€ million)	2,446,867	n/a	1,290,591	1,156,276
% GDP	136.6			
Germany (€ million)	2,062,446	510	1,033,295	1,028,641
% GDP	89.3			
Netherlands (€ million)	1,143,311	696,271	331,923	115,117
% GDP	216.6			
Italy (€ million)	916,155	21,016	554,448	340,691
% GDP	62.1			
EU25 (€ million)	17,011,150	3,293,728	7,227,498	6,489,924
% GDP	148.8			
Eurozone (€ million)	10,229,544	834,812	3,846,401	5,548,331
% GDP	122.1	8.2	37.6	54.2

Source: ECB (2007), Tables 8, 9 & 14 (own calculations)

Table 2.2 Banks in the CEEs

	Asset share of foreign-owned banks (%)		Asset share of state-owned banks (%)	
	2003	**2006**	**2003**	**2006**
Bulgaria	82.7	80.1	2.5	1.8
Czech Republic	86.3	84.7	3.0	2.2
Estonia	97.5	99.1	0.0	0.0
Hungary	83.5	82.9	7.4	7.4
Lithuania	95.6	91.8	0.0	0.0
Latvia	53.0	62.9	4.1	4.4
Poland	71.5	74.3	25.8	21.1
Romania	54.8	87.9	40.6	5.9
Slovak Republic	96.3	97.0	1.5	1.1
Slovenia	18.9	29.5	12.8	12.6

Sources: EBRD (2007); Structural Indicators

Box 2.2 About PPPs

Public Private Partnerships (PPPs) have grown rapidly since 1992, when they first appeared in the UK. The most common PPP projects are for motorways and water and waste disposal projects (particularly in France, Spain, Portugal, Italy, Greece, Ireland and the UK), followed by schools and hospitals. A variety of PPP projects are at different stages of design and procurement in Eastern Europe. The European Investment Bank is a primary or secondary funder in many types of projects. European PPP and construction companies such as Skanska (Sweden), Ferrovial (Spain), Hochtief (Germany) and Vinci, Bouygues and SITA (France) have many projects in the UK, whilst British PPP financial, legal and technical consultants and construction companies have expanded across Europe. The elements of different PPP schemes are shown in the table below.

		Out-sourcing	**Private finance initiative**	**Concession**	**Lease**	**BOT (build-operate-transfer)**
Operation	Operation of service	X	X	X	X	X
Finance	Capital investment financed by private operator		X	X		X
	Recouped by user charges			X	X	
	Recouped by contract from municipality	X	X			X
Construction	Construction of asset by private company		X	X		X
Ownership	Public during and after contract	X	X	X	X	
	Private during contract, public after			X		X
	Private indefinitely					

Source: D. Hall (2004), PPPs: A Critique of the Green Paper, PSIRU on behalf of the European Federation of Public Service Unions (EPSU)

1979 and 1997, deeply transforming the parameters of public service provision. It encompasses the privatisation and disaggregation of government service provision, the use of competition, performance measurement and tighter cost control (Needham, 2005).

Privatisation has also favoured European multinational companies, which have expanded their activities both in sectors previously owned by the state and in new areas.

For example, in the electricity sector market liberalisation in the EU has led to a growing concentration of electricity operations under a few dominant companies, notably RWE and E.oN (Germany) and EdF (France). Furthermore, some of the EU companies are taking advantage of the liberalisation and privatisation in neighbouring countries encouraged by the EU, expanding their operations in these areas (Hall, 2005).

Overall, the privatisation process served neo-liberal objectives pursued by many European governments, while enhancing the power of financial institutions and other private businesses. Although the party in government promoting privatisation was often of a conservative orientation, especially in the early stages of the process, this was by no means the rule. As privatisation spread to increasingly wider areas in the 1990s, social democratic governments continued the policies instituted by the conservative ones, while in some cases (e.g., Spain) they actually introduced them. The winners were the business interests that took advantage of the privatisation process in order to gain entry into new areas and to strengthen their position vis-à-vis their competitors on the national and on the international level.

2.3 The role of EU policy

Privatisation is not specific to Europe but is a worldwide phenomenon. Nor have the European Economic Communities and later the European Communities played a leading role in triggering the wave of privatisations which began in the late 1970s. The EU has never had any competence in the area of privatisation. Article 222 of the Treaty of Rome of 1957 states: "This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership"; and this formulation has survived all subsequent treaties, including the current Treaty of Nice, the failed draft constitution and the equally failed Lisbon Treaty'.

In spite of this original lack of enthusiasm and the continuing lack of formal competence in the European institutions, especially the European Commission (EC) and the European Court of Justice (ECJ), have become major driving forces of privatisation. It may be argued that in the first decade of this century, the EU has taken the lead in opening markets and privatising public services, and it has thus replaced the GATS on the World Trade Organisation (WTO) level as the most powerful privatisation forum in the world.

How could this happen? The answer to this question lies in the development of the concepts of liberalisation, market opening and competition. The increasing emphasis on markets and competition as central parts of the worldwide conservative roll-back strategy against the interventionist policies of post-war welfare states captured the European concept of a

Common Market and transformed it from an instrument to achieve economic and social objectives into an overarching and comprehensive social objective. The creation and impact of this privatisation-friendly framework are the themes of this part of Chapter 2. First we introduce the main cornerstones for the increasingly competition-dominated European legal and political framework (Section 2.3.1). Then we present two areas where EU legislation either generated extensive liberalisation and privatisation (network services) or where the EU is heading in this direction (social services) (Section 2.3.2).

2.3.1 Cornerstones of the legal and political framework for liberalisation and privatization

The completion of the single European market. The *first* and perhaps the most important milestone of liberalisation in the EU is the adoption of the *Single European Act (SEA)* of 1987, following the Commission's "White paper on the completion of the Single Market" of 1985 (see EC, 1985). It marks the transition from a 'positive' to a 'negative' integration strategy. In the former, the method of integration is to harmonise the different legal and institutional frameworks for markets in the member states and to create a space of common rules as a framework for competition. A negative integration strategy concentrates almost exclusively on the removal of market barriers with only very few common rules. The transition from the positive to the negative integration strategy replaces the principle of harmonisation by the principle of 'mutual recognition' which postulates that a good or service produced or offered in one member country according to the rules of this country should automatically get a 'European passport', that is, it should be admitted to the markets of every other member country even if the rules in this other country were different from those of the first country. This '*country of origin principle*' triggered the 'biggest push of deregulation in economic history' as one former commissioner put it. The result was that economic competition between firms *within a framework of common political and social rules* – relating, for instance, to work protection, taxation or product safety – was increasingly complemented and transformed into *competition of rules* between countries, or locational competition. This is the background for tax competition, social dumping and so on.

The liberalisation of financial markets: Open doors for financial investors. The SEA had also called for the liberalisation of capital movements 'to the extent necessary to ensure the proper functioning of the common market'. This objective required far-reaching legislative measures because financial markets were densely regulated in the European Communities and capital controls were not only allowed but also rather extensively practised in most countries of the European Economic Community (EEC) and the EC until

the early 1970s (see Bakker, 1996). The legislative framework for the liberalisation of financial markets was created in four steps:

- In 1988 the directive on the *liberalisation of capital markets* (88/361/EEC) was adopted which foresaw the complete liberalisation of capital movements until 1 July 1990, with longer transition periods for some countries.
- In 1989 the *second banking coordination directive* (89/646/EEC) created the 'European passport' for banks in the EC on the basis of several agreed common standards.
- The *Treaty of Maastricht* of 1992 extended the provisions of the SEA considerably insofar as it abolished the clause which linked the freedom of capital movement to the proper functioning of the common market. It called for the abolishment of all restrictions of capital movements between member states and between member states and third countries. At the same time, the treaty provided (in Articles 73c to 73g) a number of exemptions.
- The *Financial Services Action Plan* (FSAP) was adopted in 1999 as the response to the sluggish and incomplete implementation of the liberalisation imperative in most member states. It envisaged the adoption of some 40 measures to further open up financial markets until 2005 and put particular emphasis on the securities sector. By 2005 most of these measures had been adopted by the EU and many were implemented by the member states (see EC, 2005).

The services directive The aim of the famous 'Bolkestein-directive' was to generate a new thrust for the implementation of the single market program in the area of services where the implementation had in the view of the Commission remained too sluggish. The draft, which was published in January 2004, covered a very comprehensive range of services (including social and health services) and contained the explicit confirmation of the country of origin principle (see EC, 2004). However, this orientation remained not unchallenged and was met with a wave of critique, protest and mobilisation in several member countries, notably in France and Germany. Even the European Parliament did not accept the neo-liberal thrust and requested changes. As a result the Commission formulated a second version of the directive, in which the term 'country of origin' had disappeared and from which several areas of services (social and health services, labour regulation) had been removed. This version was accepted by the majority of the EP and adopted in the spring of 2006. It has been in force since January 2007. Although the critique had some impact on the final version of the directive it should not be overlooked that the basic deregulatory content was maintained.

The Lisbon strategy It was first adopted at the summit in March 2000, at the peak of the new economy boom and financial speculative bubble – which

burst a few weeks after the summit. In spite of obvious failures with regard to declared objectives, the strategy was reconfirmed at the summit in Brussels in spring 2005. It contains the essence of the deregulation and competition-oriented strategy of the EU. The three main pillars are:

1. *Structural reforms*, meaning mostly further market opening and deregulation, that is more deregulation of labour markets under the logo of flexicurity.
2. *Macroeconomic discipline*, concretised in a uniquely narrow mission, on the one hand, for monetary policy in the European Monetary Union (EMU), focussing exclusively on price stability and, on the other hand, for fiscal policies concentrating on tight restrictions for public budget deficits and public debts.
3. The *'modernisation' of social systems*, which aims at the complementation and at least partial replacement of public PAYGO pension systems by private capital funded pension systems.

2.3.2 Liberalisation and privatisation in the new framework

Liberalisation and privatisation of network services. One particular area of liberalisation during the last two decades has been network and infrastructure sectors (see Chapter 8). These particular liberalisation directives have been adopted, complemented and modified on the European level. They relate to telecommunication, postal services, energy (electricity and gas) and transport (air traffic, railways and local and regional public transport). These areas were dominated by large state-owned monopolies in most member countries. The liberalisation directives did not require privatisation. Their main thrust was to generate and ensure 'undistorted' competition in the hitherto closed markets. For these purposes, provisions were adopted to prohibit or heavily constrain state subsidies (or, where these were thought necessary to uphold a service to grant them indiscriminately to all providers) to abolish cross-subsidies, to unbundle accounting, separate different activities and so on. To monitor and ensure the implementation of the internal market and competition, rules liberalisation was regularly accompanied by the set-up of new regulatory provisions and authorities in the member states.

The guarantee of public service functions was usually not part of the liberalisation directives in the network industries. It was implicitly assumed, and sometimes explicitly formulated, that a well-working market would best serve the public service objectives, which were seen in universal access, affordable prices and high quality of the service. Only in the fields of telecommunications and postal services were these 'universal service' requirements explicitly formulated and concretised in the liberalisation directives. For electricity services a special directive imposed particular investment for reserve capacities.

While the liberalisation directives in network industries did not – with the two exceptions mentioned – contain any particular public service provisions, the member states were free to declare these services as of public interest and to impose legal provisions to fulfil the public purpose. Such provisions could, according to Article 86.2 ECT, limit the applicability of and create exemptions from the competition rules, if this was necessary to fulfil the public interest mission.

Finance as a driver of privatisation The liberalisation of financial markets through EU policies corresponded to the increasing pressures from financial investors, which had become more and more central and influential actors in contemporary capitalism. Under the new legislative framework financial investors have developed rapidly in the EU. This applies not only to the traditional institutional investors but also to new so-called 'alternative investors', private equity firms and hedge funds. The consequences have been a strong thrust towards privatisation of public goods and services, more shareholder orientation in the management of private and public firms and increased pressure on governments to shape the economy and society according to the interests of financial investors (see Chapter 5). In this context the EU has exerted considerable pressure for pension reforms, through which the traditional public pay-as-you-go-pension (PAYG) systems in several member states have been complemented and partly replaced through private capital funded schemes (see Chapter 10). The directive on "institutions for occupational retirement provision" (IORP) (EC, 2003) has explicitly opened a broad range of speculative investment opportunities for private pension funds including shares, hedge funds and currencies.[4]

Social services Immediately after social services had been exempted from the coverage of the services directive the Commission announced in an official communication in April 2006 the way in which it envisages to proceed in this area (see EC, 2006), not without emphasizing the role of these services as "pillars of European Society and the European Economy". The decisive point is that if a service is provided for money – regardless of the appropriateness of the price and of the ultimate source of finance – it is regarded as an economic activity and must be subordinated to the internal market and competition rules (see Box 2.3). Therefore, an entity providing a social service for money has to behave as if it were a private firm in a private market. It seems logical that under such circumstances there is no reason why it should not be privatised.

In a communication of November 2007 (EC, 2007, p. 5) this approach was re-iterated and concretized:

> For a given service to qualify as an economic activity under the internal market rules (free movement of services and freedom of establishment),

> the essential characteristic of a service is that it must be provided for remuneration. The service does not, however, necessarily have to be paid by those benefiting from it. The economic nature of a service does not depend on the legal status of the service provider (such as a non-profit making body) or on the nature of service, but rather on the way a given activity is actually provided, organised and financed. In practice, apart from activities in relation to the exercise of public authority, to which internal market rules do not apply by virtue of Article 45 of the EC Treaty, it follows that the vast majority of services can be considered as "economic activities" within the meaning of EC Treaty rules on the internal market (Articles 43 and 49).

While this competition-oriented view has always been the position of the Commission with regard to network, utilities and other infrastructure services of general interest (which were qualified from the beginning as being

Box 2.3 The European Commission on social services

In general, the case law of the Court of Justice ('the Court') indicates that the EC Treaty gives member states the freedom to define missions of general interest and to establish the organisational principles of the services intended to accomplish them.

However, this freedom must be exercised transparently and without misusing the notion of general interest, and the members must take account of Community law when fixing the arrangements for implementing the objectives and principles they have laid down. For example, they must respect the principle of non-discrimination and the Community legislation on public contracts and concession when organising a public service.

Moreover, when it comes to services of an economic nature, the compatibility of their organisational arrangements with other areas of Community law must be ensured (in particular freedom to provide services and freedom of establishment, and competition law).

In the field of competition law, the Court has established that any activity consisting of supplying goods and services in a given market by an undertaking constitutes an economic activity, regardless of the legal status of the undertaking and the way in which it is financed.*

With regard to the freedom to provide services and freedom of establishment, the Court has ruled that services provided generally for payment must be considered as economic activities within the meaning of the Treaty. However, the Treaty does not require the service to be paid for directly by those benefiting from it.** It therefore follows that almost all services offered in the social field can be considered 'economic activities' within the meaning of Articles 43 and 49 of the EC Treaty.

*See, for example, cases C-180/98 to C-184/98, Pavlov and others.
**Case C-253/85, Bond van Adverteerders

Source: EC (2006), p. 6

of general *economic* interest), the reach of this approach has recently been extended and now includes health care (see Chapter 9) and social services. For the latter, the main argument is the *modernisation* of such services, which previously may have been of a non-economic nature but which through this modernisation are transformed into economic services: "The combined effect of these changes is that an increasing number of activities performed daily by social services are now falling under the scope of EC law to the extent they are considered as economic in nature" (EC, 2007, p. 8).

If the diagnosis that public services contain increasingly economic elements including remuneration to providers (whether publicly financed or not) is correct – and there is no reason to believe that this is not the case –, the allegedly large room for discretion for national, regional and local actors and authorities to organise and shape public services according to their needs and preferences for which the internal market framework does not apply, becomes increasingly fictitious and a more and more rhetoric shell. The reasoning of the Commission is a strange combination of limitation and extension of the internal market rules. Limitation: Only services of an economic character are within the reach of the Commission. Extension: Almost all services are of an economic character.

Overall, the approach of the EU to social services can be summarized as follows:

First, services of general ***economic*** interest fall in principle into the framework of internal market and competition rules, but may be granted exceptions from these rules under certain circumstances and conditions; non-economic Services of General Interest (SGI) fall outside the reach of the treaty and thus of European legislation. *Second*, modernisation and other changes transform more and more previously non-economic services of general interest into ***economic*** ones, so that in a long-term perspective all public services fall under the rules of the treaty. *Third,* the way of preserving (or even, if there is a political will, extending) public interest provisions goes via exceptions and exemptions from the internal market and competition rules. Even if this option is extensively used and political forces and social movements fighting for public interests become stronger and enforce a wide range of exceptions, the – implicitly or explicitly – acknowledged frame of reference remains the internal market and competition rules.

2.4 Summary

The economy of the Western European countries, which constituted the EU-15 by the mid-2000s,[5] was deeply transformed by the liberalisation and privatisation policies of the past 30 years. The role of the state as the provider of welfare was diminished, to the detriment of European society and of the public interest. While the actual process followed from one region to another was not identical, in terms of chronological order, sectors and

methods involved, and so on, there was a common thrust. In fact, starting from the 1990s onwards, privatisation policy became increasingly formalised, as well as central, within the overall EU policy orientation. The 2007–2008 crisis, which threatens to engulf more and more sectors of the European economy, may well lead to a new wave of nationalisations. Whether this signifies a reversal of privatisation policy or a temporary break depends on the perception of the role of the state in the new conjuncture.

The EU, though formally not competent to recommend or impose privatisation, has in fact played a major role in the privatisation process in the EU, particularly in the ongoing process of the privatisation of public services. The reason for this is the increasingly dominant conception of liberalisation and competition which has been implemented in several steps as an overarching framework for economic and social activities. It forces all public service providers to behave as if they were private profit-seeking entities. This has led to the privatisation of almost all network services, and currently the focus of the stampede for privatisation is on social services and health care.

Notes

1. Following the credit crunch of 2007 and the financial crisis of 2008, which is quickly turning into an economic crisis of global proportions in 2009, the bail out of large financial and industrial concerns by the state in the USA and in other major economies confirms the view that nationalisation is most often employed as a rescue policy at times of economic and social hardship, as opposed to privatisation, which is a deliberate type of policy in terms of design and execution, promoted by particular corporate group interests.
2. The Privatisation Barometer data includes only privatisation revenues from public share offerings and private sales. In view of the different forms privatisation may take, such data understates the size of privatisation proceeds.
3. See also Table 12.4 in Chapter 12.
4. Par. 33 of the introduction to this directive: "As very long-term investors with low liquidity risks, institutions for occupational retirement provision are in a position to invest in non-liquid assets such as shares as well as in risk capital markets within prudential limits. They can also benefit from the advantages of international diversification. Investments in shares, risk capital markets and currencies other than those of the liabilities should therefore not be restricted except on prudential grounds."
5. In 2004, ten new member states joined the EU and in 2007, two more, bringing total EU membership to 27 and encompassing the largest part of Europe.

References

Bakker, Asge F. P. (1996) The Liberalisation of Capital Movements in Europe. The Monetary and Financial Committee and Financial Integration 1958–1994 (Dordrecht et al.).

Bortolotti, B. (2005) Political Institutions and Privatisation Policy (CESifo DICE Report 1/2005).
Boutchkova, M. K. and Megginson, W. L. (2000) "Privatisation and the Role of Global Capital Markets", *Financial Management*, Winter, pp. 32–76.
Etzioni, Amitai (2008) Closing the Community Deficit in the EU (CEPS Policy Brief No. 169, September 2008).
European Commission (EC) (1985) Completing the Internal Market. White Paper from the Commission to the European Council (COM 310 final, 14 June).
European Commission (EC) (2003) Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision of 3 June 2003 (OJ L235/10, of 23 September).
European Commission (EC) (2004) Proposal for a Directive of the European Parliament and of the Council on Services in the Internal Market (COM (2004) final/3 of 5 March).
European Commission (EC) (2005) FSAP Evaluation, Part I: Process and Implementation (Brussels).
European Commission (EC) (2006) Implementing the Community Lisbon Programme. Social Services of General Interest in the European Union (COM (2006) 177 final).
European Commission (2007) Services of General Interest, Including Social Services of General Interest: A New European Commitment (COM(2007) 0725 final of 20.11.2007).
Hall, D. (2005) "Public Resistance to Privatisation in Water and Electricity" in *Public Services Overview* 2005/6 (Trans Global Institute).
McDonald, D. A. and Ruiters, G. (2005) "Rethinking Privatisation: Towards a Critical Theoretical Perspective" in *Public Services Overview* 2005/6 (Trans Global Institute).
Morano, V. P. (2005) Privatisation as a Driver of Economic and Financial Integration (Rome), http://www.privatizationbarometer.net (accessed 13 May 2005).
Needham, C. (2005) "The Evolution of Public Services in the UK", *Public Services Overview* 2005/6 (Trans Global Institute).
OECD (1995) "Deregulation and Privatisation in the Service Sector", *Economic Studies*, No. 25, 1995/II, pp. 32–74.
OECD (2003) Privatizing State-Owned Enterprises – An Overview of Policies and Practices in OECD Countries (Paris). PB Newsletter (2006) No. 4, p. 6 (A Publication of the Privatization Barometer), www.privatizationbarometer.net

3

Privatisation in the Central and East European Countries

Károly Lóránt

3.1 Introduction

The newer EU member states (except for Cyprus and Malta) became either part of the Soviet Union or in its zone of influence following World War II. As a result, these countries were obliged to follow communist ideas regarding the political system and the economy. The people of these countries made continuous efforts to rid themselves of the system of a centralised political power and attempted to develop a more flexible economic system. These attempts were mirrored in the Hungarian uprising in 1956, in the 'Prague's spring' during 1968 and also in the fighting of the Solidarnost in Poland in the early 1980s. In Hungary, the reform of the economic system in 1968 led to the establishment of a better functioning economy. However, these attempts either failed or were not sufficient to accomplish an effective economy and by the late 1980s a wide strata of the leading intelligentsia, even members of the Communist Party, thought that the system itself needed to be changed. With the weakening of the Soviet Union, the time for change arrived. The Baltic countries achieved their independence and a democratic multiparty political system was established in the region. The next step of the transformation was the establishment of a market economy. In the framework of this transformation of the previously state-owned companies were privatised; the markets (labour and capital market), the price system, and foreign trade were liberalised; and restrictions on business and individuals were removed, reduced, or simplified with the intention of encouraging the efficient operation of markets. In this way, the former centrally planned economies were transformed into market economies dominated by private property. The intent of this chapter is to give an overview of these processes, focusing on privatisation and its economic and social impacts.

3.2 Systemic change and the philosophy behind privatisation

Systemic change in the Central and East European Countries (CEE) began in the era when neoliberal ideas about state property were on the zenith in the West. Mainstream economists of the socialist countries adopted the new ideology not least because these ideas were strongly recommended by the World Bank and International Monetary Fund (IMF). The so-called structural adjustment policies suggested by the World Bank also included proposals for privatisation. The influence of these organisations was especially strong in indebted countries like Poland and Hungary who were obliged to borrow from them.

Proponents of the neoliberal-style economic reforms also supported the large scale privatisation of state properties 'at once'. These theorists argued that state property is inefficient, and an inefficient system should not be allowed to survive. It was also supposed that new, market-oriented owners would tackle the necessary modernisation of enterprises after property rights were transferred.

Supported by international organisations and economic theorists, almost all political parties, established in the course of the systemic change, not surprisingly were in favour of privatisation. The reasoning for privatisation was somewhat different in the individual countries; however, these ideas had some common features. For instance, it was taken for granted everywhere that private property and private enterprises would be more efficient than the state-owned ones. New political parties everywhere wanted to provide some kind of historical justice for the pains caused by communism. And it was supposed that through privatisation a new middle class ('the citizens') would come into existence and provide the backbone of the new democratic political system.

3.3 Privatisation methods

Following the systemic change for the new political forces one thing was clear: the radical change in the structure of ownership of privatisation was indispensable. The main question was how to carry out privatisation when there were no investment funds or corporations to purchase the state properties and the citizens did not have enough savings to buy state enterprises.

In the absence of investors CEE countries had to find a completely new solution in order to make state property private. From this point of view, privatisation methods can be divided into two main groups:

1. Conventional methods which were also applied in the West, like direct selling, initial public offering (IPO) and tender.

2. Innovative, nontraditional methods like self-privatisation, auction, coupon system (vouchers), management and employee buy-out (MEBO) and restitution. With these methods, mostly the former managers of the privatised companies were able to acquire the state property.

The main legal framework for privatisation was established between 1988–1991. In all the CEE countries, parliaments approved laws about economic associations (the basis for establishing private enterprises), about the process of transforming state property into private property and also about the possibilities for foreign investors to participate in this privatisation.

The very process of privatisation was conducted either directly by the state (through the ministries) and by special agencies established specifically for this purpose (for example State Property Agencies) or indirectly, with the help of numerous agencies for which the ownership rights were conferred until the state-owned enterprises were sold by them.

Privatisation was facilitated by different institutions such as schemes that helped managers and employees to buy the privatised enterprises or special investment funds for buying up the vouchers and property agencies which actually carried out the owner's duty.

Naturally, the methods would depend upon the size of the state enterprise in question. Public auctions were generally used in the case of small businesses, medium-sized enterprises were privatized by the management or done by agencies, while larger enterprises were more often transformed into joint-stock companies and later their shares were sold to specific professional investors or were introduced into equity markets.

Table 3.1 shows the dominant privatisation methods in the individual countries with these general features.

Table 3.1 Dominant privatisation methods

	Primary method	**Secondary method**
Bulgaria	direct sales	vouchers
Czech Republic	vouchers	direct sales
Estonia	direct sales	vouchers
Hungary	direct sales	MEBO
Latvia	direct sales	vouchers
Lithuania	vouchers	direct sales
Poland	direct sales	MEBO
Romania	MEBO	direct sales
Slovak Republic	direct sales	vouchers
Slovenia	MEBO	vouchers

Source: Bennett et al. (2004)

3.4 The impact of privatisation on ownership structures

The different methods of privatisation played a determinant role in the post-privatisation structure of the CEE countries. Auctions for the privatisation of smaller companies created a relatively wide strata of owners; however, with not too many perspectives. Following the liberalisation of foreign trade these small businesses were obliged to compete with large multinational companies (especially in the field of retail trade) and, naturally, could only reach a very limited level of success. Other methods, which produced bigger domestic private companies, also had limited success in reaching strong national private 'champions'. The reason was the same: privatised state companies had limited resources to improve their technology and compete on the European single market. As it turned out from a study carried out in the Czech Republic (Kocenda and Svejnar, 2003), a significant improvement in profitability and sales occurred only in cases where the state property was privatised to foreign strategic investors who financed and carried out large-scale restructuring. In cases where private owners were in fact domestic ones, the economic performance hardly improved, but if it did, it was a consequence of reduction in labour costs.

The first wave of mass privatisation originally resulted in a rather unstable ownership structure. Namely, many new 'voucher capitalists' sold their shares soon after a two-year embargo period, preferring cash to equity, which also affected newly emerging capital markets by creating a predominance of the secondary over primary market, and by converting savings into consumption rather than financial assets. In countries where the coupon privatisation was the dominant method, large stakes in privatised companies ended up in the hands of quasi-governmental funds and private investment funds. These funds became the new majority owners of the economy.

With the Management and Employee Buy-Out (MEBO) method in Slovenia, workers and managers obtained a majority in 802 companies (61.3 per cent of all of companies), but these accounted for only 22.9 per cent of total capital, while in 150 companies (11.5 per cent), accounting for 45 per cent of the total, capital insiders acquired less than 20 per cent of shares.

Since a great part of shares sold on public auctions finally landed in the hands of state-owned funds in Slovenia, state ownership exceeds 25 per cent in 10 of 28 most important companies listed on Ljubljana's Stock Exchange. The real dominance of the state in the economy has been further enhanced by the weakness of dispersed small shareholders and by the state-controlled shareholders (that is, state-owned banks and other state-owned companies). Thus, the state, the shareholders owned by the state and the state-controlled shareholders own around half of the shares in the biggest companies.

In Romania, all the important types of owners are present in the post-privatisation ownership structure. The State Ownership Fund, representing the state, has been, and it still is, an influential owner of many firms.

The five Private Ownership Funds' portfolio and name changed after the voucher privatisation, but the identity of their real owners is still an open question: it is certain that the citizens are not among them (Filip Codruta-Liliana, 2007). Besides the above-mentioned state and private investment funds, a complete set of real private owners emerged because of MEBO, mass privatisation and case-by-case sales. MEBO, being the most popular in the first years of transition (1993–1995), gave space for insiders and a large number of domestic individuals received tiny fractions of ownership. The last method, direct sale of shares, was mostly used after the Mass Privatisation Program (1996–2000) and was the most important method to involve foreign investors and give way to foreign ownership.

In Hungary, the main beneficiaries of the privatisation were the multinational companies. Around two thirds of the privatised wealth went into foreign hands. And foreign participation increased further when foreign owners increased capital and bought shares or in other ways bought the assets of Hungarian owners. The main foreign owners by country of origin are the EU (mainly Germany and France) and the United States.

3.5 Privatisation of the banking sector

Privatisation of the banking sector in the CEE countries was carried out in two stages. In the first stage, a two-level banking system was established where the commercial banking activity was separated from the activity of the central bank activity, which had been incorporated in one hand (one central bank) during the socialist epoch. These changes were carried out in the late 1980s and early 1990s. As a second step, individual commercial banks were privatised usually either by open sale of their shares on the stock exchange (initial public offering – IPO) or by selling the majority of the shares to strategic (professional) investors who actually were the leading banks of the "old" Europe, like ING bank, ABN-AMRO, KBC, Uni-Credito, or American banks like Citigroup or GE Electric. By the end of the 1990s, bank privatisation was practically completed in all of the new member states. As a result, in most CEE countries a great majority (50–100 per cent) of the banking and insurance sector went over to big multinational financial actors, the only exception being Slovenia where the banking and insurance sector was returned to the hands of national owners (Štiblar, 2007).

3.6 Privatisation of the network industries

3.6.1 Energy

In the new member states, during the period of state socialism, the three segments of the electricity sector – production, transmission and distribution (sales) – were operated within the same state-owned company. Thus, the first step of privatisation (usually during the 1990s) was the separation

of the power plants from transmission greed and the distribution networks. In the second step, these separated parts were transformed into joint-stock companies; and finally, certain packages of stocks were offered to professional investors and another part was sold on the stock exchange, while some part of the stake remained in state hands.

The declared objectives of privatisation were the reconstruction of the old power plants and the strengthening of their capital, management skills and the quality of their portfolio. Improving the quality of the services and increasing the competitiveness were also among the expected goals. However, sometimes the financing of the state budget was also a high priority. Privatisation was carried out in successive steps and during different time periods in different countries. In several countries, such as Hungary, the majority of the process of privatisation took place in the middle of the 1990s, while in other countries it began only in recent years (for instance, in Poland and Romania). In certain countries, progress was rather slow or did not happen at all (for instance, Slovenia). Privatisation was also influenced by the obligation to comply with EU legislation, namely with the Electricity Directives, (96/92/EC) and (2003/54/EC). Through these directives, the electricity market of the new member states has been gradually opened for competition. Due to the lack of domestic capital privatisation gave ground to big multinationals. Today a great part of the energy market of the CEE countries is in the hands of large West European companies like EdF (France), Enel (Italy) and RWE (Germany).

3.6.2 The gas and oil industry

In the gas and oil industry privatisation was carried out in the form of establishing joint-stock companies. The minority shares were sold on stock markets, while state or domestic investors retained the majority share, as – for instance – in the case of the Polish PGNiG and Hungarian MOL.

3.6.3 Telecommunications

In the domain of telecommunication the privatisation process followed a similar pattern. In the first step, the state-owned enterprises were transformed into joint-stock companies and then a part of the shares was sold on the stock market, but the bulk of the stake went to professional investors. Since in almost all CEE countries the telecommunications supply was underdeveloped (for instance in Poland the number of telephone lines per 100 people was 7 in 1989 while the same data for West Germany was 43), the main goal of privatisation was to increase the quality of service by involving professional Western telecom companies. Currently, the big Western telecommunication firms like Deutsche Telekom, France Telecom, Vodafon, Cosmote and Telenor dominate the telecommunication markets of the CEE countries.

3.6.4 Railways

Railway privatisation started only in recent years along with the EU's directives to establish a common market for the transport industries. The implementation of the first railway package (Directives 2001/12/EC, 2001/13/EC and 2001/14/EC adopted in February 2001) made it obligatory for member states to provide free access to the national railway network. For this purpose, the originally state-owned railway monopolies were split up into parts with the aim of separating the network (railway track) from the personal and freight transport operators. Since personal rail transport usually produces losses, while freight transport make profits, the former remained in state ownership while the latter became the target of privatisation. Just recently (2008) the Austrian Rail Cargo acquired the Hungarian MÁV Cargo and ÖBB (Austrian Federal Railways) acquired minority share of Slovak Rail-Cargo enterprise. Railway privatisations were accompanied by massive strikes, especially in Poland and Hungary.

3.6.5 Water resources

Water privatisation led to strong resistance in the CEE countries. In May 2002, the city council of Poznan, Poland (with a population of 650,000) unanimously rejected a water privatisation proposal. The city council of Szeged, Hungary decided to terminate the concession to Vivendi's subsidiary and take back the operation of the water company in house. In spite of strong resistance, the privatisation process is slowly advancing and the main investors are the Western water and sewage companies like Vivendi, Suez Lyonnaise and SAUR (all French companies).

3.7 Privatisation of health care

Prior to systemic change, the CEE countries shared similar health systems based on the 'Semashko[1] model' developed in the Soviet Union in the early 1920s. The 'Semashko model' financed health services entirely through the state budget; the health care facilities were in state ownership; doctors and employees were civil servants; and health care was provided free to the whole population. However, following the oil price crisis in the 1970s the financing of health care services couldn't keep pace with fast-growing expenditures. Health care became underfinanced. This was mirrored in the salary of personnel, the shortage of nurses, the long waiting lists and in the poor provision of equipment. In this situation, reform of the whole system was seen as the solution.

Health care reform in the CEE countries was a gradual process. In some countries, such as Hungary, it began in the late 1980s when the social security system was separated from the overall budget and a Social Insurance Fund was established, this was later divided into a Health Insurance and a Pension Insurance Fund. In the next step, the ownership of primary care surgeries, polyclinics and hospitals was devolved from the national to local

government along with the responsibility to ensure the supply of health care services to the local population. The new owners became responsible for the costs of maintenance and investment. However, they were supported by the central government with a system of 'earmarked and target subsidies'. In the framework of the reforms a family doctor system was established when citizens were allowed to choose their family physicians. Family doctors were financed by the Health Insurance Fund according their clients by a system of capitation payments. In addition, family doctors were encouraged to become private and contract with the local government for the provision of primary care services, while surgeries and equipment remained in the ownership of the local authorities.

The real privatisation of health care began with dental services, which was followed by the privatisation of hospitals and insurance. In fact, while the privatisation of dental services was more or less accepted by the public, the privatisation of the hospitals and insurance encountered fierce resistance from both the physicians and the population. For instance, when the Hungarian Parliament adopted an act in May 2003 giving the green light to the privatisation of health care institutions and hospitals the bill met with strong opposition from both the Hungarian Chamber of Physicians and the Democratic Union of Health and Social Care Employees, the two largest interest representation organisations in the sector. In a referendum held on 5 December 2004, the vast majority of voters rejected the health care privatisation. However, against this result, and many demonstrations since then, the socialist government has continued its efforts to carry out privatisation in both the fields of hospitals and insurance.

The situation is the same in Poland, where in November 2008 the liberal government pushed through the Sejm and the Senate a reform package which gave free way to the privatisation of health care. Trade unions objected to the bill and those on the right wing of the political system also rejected it. The emphasis was that human health (that is a sick person) is not to be viewed as merchandise and cannot be turned into such.

In the Czech Republic similar reforms were carried out to those in Hungary and the trade unions also reacted in a similar way.

In Slovenia, the tension is moderate because the privatisation of health care infrastructure and management has so far been limited.

Summing up, the privatisation of health care is in progress in the CEE countries; however, social resistance against it is also growing.

3.8 Economic impact

Unlike the practice in the 'old' member states where privatisation was more or less an autonomous process, in the CEE countries it became part of the transition, when not only the ownership of the production means changed but also the economic and the political systems. For this reason,

in economic and social development, the impact of political changes and of the liberalisation and privatisation process are simultaneously mirrored. The deregulation of economic life, the collapse of the earlier COMECON system and, naturally, the impact of the accession to the European Union should also be considered.

3.8.1 The initial fallback and the emerging dual economy

The transition, with its liberalisation, privatisation and deregulation in most of the CEE countries, led to a 3- or 4-year fallback in terms of economic output. In some countries, the contraction of the Gross Domestic Product (GDP) reached 30 to 50 per cent and it took 7 years (sometimes more) until the output could reach its pre-transition level (Figure 3.1).

Foreign capital often forms an enclave in the economies of the CEE countries and constitutes a special sector from where the production goes almost entirely to exports and the material input comes from imports. The host country contributes to the production only with cheap and educated labour and some services. There is no real integration between the local economy and the multinational companies. From this point of view, we can say

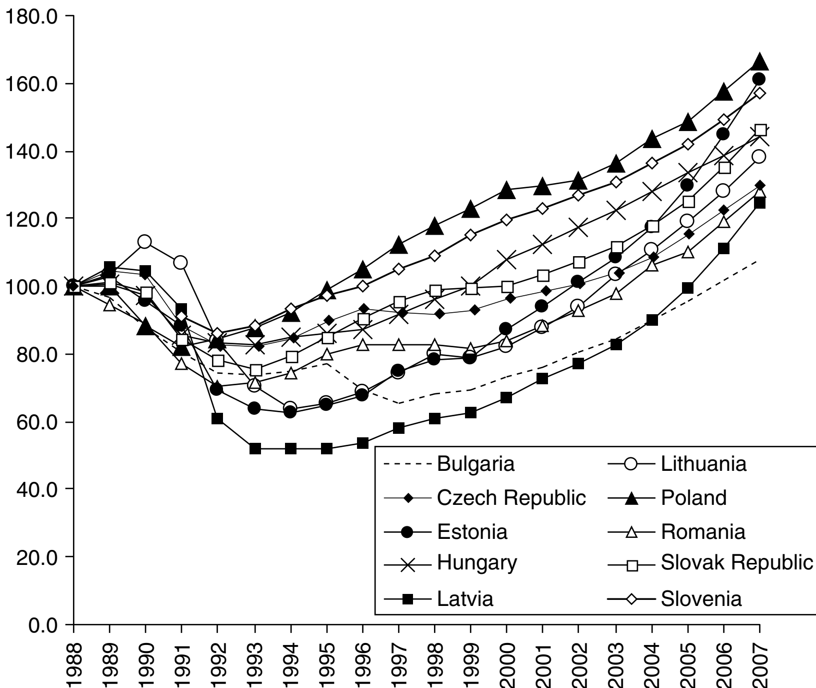


Figure 3.1 Real GDP levels in the new EU member countries 1988 = 100

that the economies of the CEE countries have a dual character. This dual character explains why against the high economic and export growth, the budget and the current account of these countries tend to deteriorate: the foreign companies contribute significantly to the GDP growth. However, their profit-repatriation draws the income out of the country, while the domestic economy lacks the necessary resources to catch up with its Western competitors.

3.8.2 The impact of foreign direct investment

Following liberalisation and privatisation, foreign ownership became dominant or at least significant in the majority of the CEE countries. The yearly net foreign direct investment in the CEE countries rose tenfold between 1993 and 2006 from US $5.4 billion to US $58 billion.[2] The ratio of Foreign Direct Investment (FDI) stock in GDP, which was practically zero at the beginning of the systemic change, reached 57 per cent in 2007(Eurostat, 2009). Table 3.2 shows the ratio of the inward FDI stock in the GDP, which was negligible at the time of the systemic change. In 2007 it already exceeded one third of GDP in almost all the CEE countries and in several countries (Hungary, Bulgaria and Estonia) it is extremely high. At the same time, the high negative balance between the inward and outward flow of FDI shows that it is not integration as in the case of the old member states, where the FDI stock in the GDP is also high but it is mutually balanced. In the case of the CEE countries, the high ratio of FDI causes a one-sided dependence on the activity of the multinational companies.

Foreign direct investment has had a decisive role on the economic growth of the CEE countries, although its calculation is surrounded by some uncertainties. However, it is undeniable that the fast-growing industrial production in the CEE countries since the middle of the 1990s is mainly due to the multinational companies which took part in the privatisation or were engaged in green field investments.

Foreign direct investment went primarily to those countries that were most developed at the beginning of the transformation process, offered the best economic environment at an early stage and were the first candidates for EU accession. However, the same foreign direct investment put obstacles to the development of the domestic industries and caused the deterioration of the current account balance in countries like Poland and Hungary, where foreign ownership became dominant.

3.8.3 The current account problem

In the past few years (2005–2007 average), as compared to the 1995–1997 period in four countries (Bulgaria, Estonia, Latvia and Romania), the current account deficit increased substantially, sometimes reaching 10–20 per cent of the GDP, while in Lithuania it did not change; however it was high also in the previous period (Table 3.3). In Hungary, though the current account

Table 3.2 Foreign direct investment stocks as per cent of the GDP

	1990			2007		
	Outward	**Inward**	**Difference**	**Outward**	**Inward**	**Difference**
EU-15 (unweighted average)	11.5	10.9	0.6	40.0	34.2	5.8
United Kingdom	23.2	20.6	2.6	61.2	42.0	19.2
Netherlands	36.3	23.3	13.0	105.0	86.7	18.3
France	9.0	7.1	1.9	52.5	38.9	13.6
Finland	8.2	3.7	4.5	43.2	33.5	9.7
Sweden	21.1	5.3	15.8	66.6	57.9	8.7
Germany	9.1	6.7	2.4	35.0	28.1	6.9
Italy	5.5	5.4	0.1	23.0	16.1	6.9
Denmark	5.5	6.9	–1.4	54.0	47.4	6.6
Spain	3.0	12.5	–9.5	38.1	39.0	–0.9
Austria	2.9	6.6	–3.7	31.2(b)	32.8(b)	–1.6(b)
Greece	3.4	6.8	–3.4	9.4	15.9	–6.5
Slovenia	1.5	3.8	–2.3	14.2	27.7	–13.5
Ireland	36.4	119.5	–83.1	52.0	68.9	–16.9
Belgium	19.4	27.8	–8.4	103.8(a)	132.3(a)	–28.5(a)
Lithuania	–	–	0.0	3.8	36.2	–32.4
Latvia	–	–	0.0	3.1	37.1	–34.0
Poland	0.6	0.2	0.4	4.3	38.6	–34.3
Romania	–	–	0.0	0.7	35.2	–34.5
Cyprus	–	–	0.0	38.7	76.8	–38.1
Estonia	–	–	0.0	26.7	74.2	–47.5
Hungary	0.5	1.6	–1.1	73.3	121.1	–47.8
Slovak Republic	0.0	0.5	–0.5	2.0	50.5	–48.5
Czech Republic	0.0	3.7	–3.7	3.3	58.8	–55.5
Bulgaria	–		0.0	1.4	87.9	–86.5
Malta	0.0	18.6	–18.6	15.5	103.6	–88.1
10 CEECs (unweighted average)				13.3	56.7	–43.5

(a) = 2005, (b) = 2006

Source: UNCTAD (2006), p. 307 and Eurostat (Direct investment stocks as % of GDP, 28 January 2009)

Table 3.3 Balance of payments and general government deficit of the CEE countries

	Goods	Services	Income	Transfers	Current account	Current account in GDP	GDP growth rate	Gen gov deficit in % of the GDP	Yearly inflation
	euro, billion					per cent			
1995–1997 average									
Bulgaria	0.2	0.1	–0.3	0.1	0.2	1.7	–4.0	–2.6	92.6
Czech Rep.	–3.9	1.5	–0.5	0.3	–2.5	–5.2	3.3	–2.2	8.6
Estonia	–0.8	0.4	0.0	0.1	–0.3	–8.1	6.6	0.6	20.5
Latvia	–0.7	0.4	0.0	0.1	–0.2	–3.7	3.7	–0.9	16.9
Lithuania	–0.7	0.1	–0.1	0.1	–0.7	–9.4	5.0	–6.7	24.8
Hungary	–1.9	1.7	–1.3	0.1	–1.3	–3.8	2.5	–4.8	23.4
Poland	–5.2	2.7	–1.1	1.3	–2.3	–1.7	6.8	–3.8	20.4
Romania	–1.7	–0.3	–0.2	0.4	–1.8	0.0	7.1	–3.7	75.3
Slovenia	–0.7	0.5	0.1	0.1	0.0	0.1	4.2	–1.8	10.6
Slovakia	–1.3	0.2	0.0	0.2	–1.0	–5.7	5.9	–8.1	7.2
CEEC	–16.6	7.4	–3.4	2.8	–9.9	–4.0	4.1	–3.4	30.0
CEEC weighted						–2.8	5.0	–3.8	26.8
2005–2007 average									
Bulgaria	–5.8	0.9	–0.2	0.6	–4.5	–17.2	6.2	1.7	7.0
Czech Rep.	2.6	1.6	–7.2	0.0	–3.0	–2.6	6.4	–2.4	2.2
Estonia	–2.1	0.9	–0.7	0.1	–2.0	–14.3	8.6	2.4	5.1
Latvia	–3.8	0.6	–0.4	0.4	–3.3	–19.3	10.9	–0.2	7.9
Lithuania	–0.5	0.8	–0.8	0.6	–2.6	–10.6	8.2	–0.7	4.1
Hungary	–0.3	1.2	–6.6	0.3	–5.5	–5.9	3.1	–7.4	5.1
Poland	–6.3	1.4	–7.4	5.1	–7.3	–2.5	5.5	–3.4	2.0
Romania	–12.4	0.0	–3.4	4.4	–11.4	–11.1	6.1	–2.0	6.9
Slovenia	–1.3	0.9	–0.5	–0.2	–1.0	–3.2	5.7	–0.7	2.9
Slovakia	–1.7	0.4	–1.9	–0.1	–3.3	–7.4	8.5	–2.7	3.0
CEEC	–31.8	8.5	–29.1	11.2	–43.8	–9.4	6.9	–1.5	4.6
CEEC weighted						–5.6	5.8	–3.0	3.5

Source: Eurostat (Balance of payments – International transactions, 28 January 2009)

deficit is not extremely high, the accumulated foreign debt causes difficulties in financing of the current account. The deteriorating current account is due mainly to the fact that these countries with the privatisation and liberalisation of their economies lost substantial part of their domestic and foreign markets. It is mirrored in the deteriorating balance of trade. Even when the trade balance did not deteriorate because the established multinationals produced a significant export surplus (as in the case of Hungary) their growing profit-repatriation made the current account even worse off (see Table 3.3).

Bulgaria, Estonia, Latvia and Romania can be grouped together since their current account deficit comes first from the lost market share causing the deteriorating balance in trade of goods. However, these countries – thanks to the activity of multinationals settled there – enjoy a high growth rate and their general government expenditures are more or less in balance. This shows that the current account deficit is not in every case the outcome of the general government overspending but it may stem from imbalanced foreign economic connections.

Hungary is in a separate category, this is because the country's trade improved due to the huge export surplus of the multinationals established there, but since these firms repatriate their income, the current account deficit is growing. What is more, the current account deficit is accompanied by huge general government imbalances and very slow economic growth. Having a high current account and a general government deficit at the same time, Hungary was a typical example of the twin deficit between 2005–2007.

Poland is a special case too. While the balance of trade did not deteriorate significantly, the growing negative balance of the repatriated profit and other income is offset by the transfers the Polish migrant workers send home. In this way, the current account deficit can be kept within moderate limits.

The Czech Republic, Slovakia and Slovenia are countries that were doing well until the economic crisis that began in 2008. They enjoyed high growth rates and modest current account and general government deficit. In the case of Slovakia, the current account deficit was relatively high, but it had an improving tendency, while the country's economic growth was prominent.

The high current account deficit pushed Hungary and Latvia to the brink of bankruptcy in the autumn of 2008 when, as a consequence of the world financial crisis, the fresh loans dried up and these countries were unable to finance their current account deficit from the money market. The International Monetary Fund, the World Bank and the European Union hurried to provide loans to prevent Hungary and Latvia from going bankrupt.

3.9 Social impact

One of the expectations of the political forces that carried out the systemic change was that privatisation would establish a strong middle class. Contrary to this expectation, privatisation benefited only a rather narrow strata of society. The increasing social inequalities not only did not lead to the emergence of a broader middle class, but also contributed to the dwindling of the existing one. During the transition process a substantial part of the workforce lost their jobs and only a fraction of them were able to come back to the labour market. For instance, in Hungary one third of the jobs were liquidated and the employment rate has hardly improved since then. The situation is not much better in the other countries either. From Table 3.5 it can be seen that in seven of the ten CEE countries the employment rate is lower than the EU-15 average.

In the wake of the transition, unemployment soared and especially long-term unemployment remained high. In six CEE countries it is higher than the EU-15 average (see Table 3.5).

The privatisation of public utilities (electrical energy, water, gas supply) resulted in dynamic price increases considerably above the average inflation, contributing to the impoverishment of those who were unable to increase their income at a similar pace.

Table 3.4 Unemployment rates (total unemployment)

	CZ	EE	HU	LV	LT	PL	SK	SI	EU15
1990	0.3	–	0.8	–	–	6.1	0.6	–	–
1995	3.0	1.8	10.4	6.4	6.1	14.9	13.8	7.4	–
1998	6.4	9.2	8.4	14.3	13.2	10.2	n/a	7.4	9.3
1999	8.6	11.3	6.9	14	13.7	13.4	16.7	7.2	8.5
2000	8.7	12.5	6.3	13.7	16.4	16.4	18.7	6.6	7.6
2001	8.0	11.8	5.6	12.9	16.4	18.5	19.4	5.8	7.2
2002	7.3	10.3	5.8	12.2	13.5	19.9	18.7	6.3	7.6
2003	7.8	10.0	5.9	10.5	12.4	19.6	17.6	6.7	7.9
2004	8.3	9.7	6.1	10.4	11.4	19.0	18.2	6.3	8.0
2005	7.9	7.9	7.2	8.9	8.3	17.7	16.3	6.5	8.1
2006	7.1	5.9	7.5	6.8	5.6	13.8	13.4	6.0	7.7
2007	5.3	4.7	7.4	6.0	4.3	9.6	11.1	4.9	7.0
2008	4.4	6.0	7.9	7.3	5.7	7.1	9.6	4.5	7.1

Source: 1999 World Development Indicators CD-ROM and Eurostat (Unemployment rate by gender 28 January 2009)

Table 3.5 Harmonised long-term unemployment and activity rate (2007)

Country	**Long term unemployment rate**	**Country**	**Employment rate**
Slovakia	8.3	Denmark	77.1
Poland	4.9	Netherlands	76.0
Germany	4.7	Sweden	74.2
Bulgaria	4.1	United Kingdom	71.5
Greece	4.1	Austria	71.4
Belgium	3.8	Cyprus	71.0
Portugal	3.8	Finland	70.3
Hungary	3.4	Estonia	69.4
France	3.3	Germany	69.4
Romania	3.2	Ireland	69.1
Italy	2.9	Latvia	68.3
Czech Republic	2.8	Portugal	67.8
EU15	2.8	Slovenia	67.8
Malta	2.7	**EU15**	67.0
Estonia	2.3	Czech Republic	66.1
Slovenia	2.2	Spain	65.6
Spain	1.7	Lithuania	64.9
Finland	1.6	France	64.6
Latvia	1.6	Luxembourg	64.2
Ireland	1.4	Belgium	62.0
Lithuania	1.4	Bulgaria	61.7
Netherlands	1.3	Greece	61.4
United Kingdom	1.3	Slovakia	60.7
Austria	1.2	Romania	58.8
Luxembourg	1.2	Italy	58.7
Sweden	0.9	Hungary	57.3
Cyprus	0.7	Poland	57.0
Denmark	0.6	Malta	54.6

Source: Eurostat (Long-term unemployment rate by gender, 28 January 2009); Eurostat (Employment rate by gender, 28 January 2009)

The GINI coefficient clearly shows the growth of income inequality in all the CEE countries; the increase was especially strong in Estonia, Latvia, Poland, Slovenia, Slovakia and Bulgaria, while it remained relatively modest in the Czech Republic and Hungary (Figure 3.2).

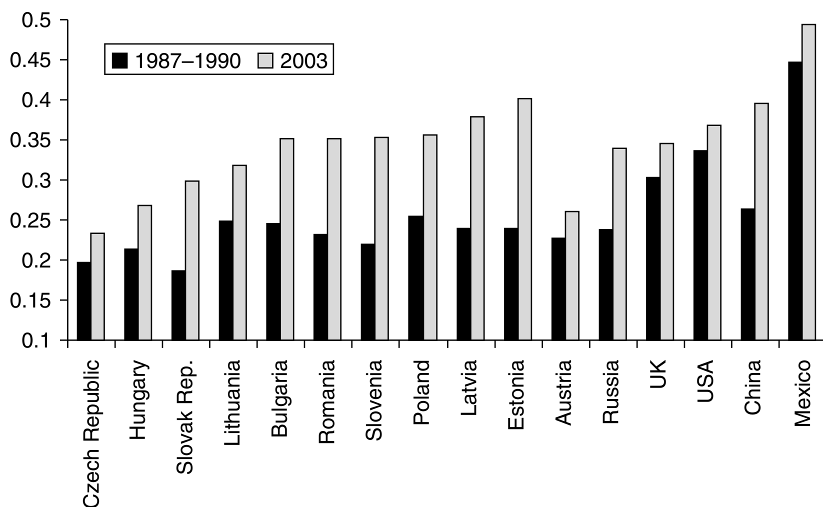


Figure 3.2 GINI index for per capita incomes from 'official' sources
Source: Mitra et al., 2006

Undoubtedly, there have been substantial improvements in the provision of consumer goods to the broad strata of the population in the CEE countries. The possession of a high-quality private car became a prestige symbol; a majority of car owners in the CEE countries replaced their Eastern origin cars with Western cars. Market liberalisation also helped consumers to purchase state-of-the-art equipment and the privatisation of telecommunications considerably improved the volume and quality of this service.

In general, one can say that the winners of transition were those who were young, well educated, well connected and entrepreneurial; especially those privileged enough to grasp the assets of the state-owned firms. On the other hand, the losers were more numerous and diverse and comprised the old, the pensioners in general, the less educated, women, those with little or no skill, rural people living in remote regions or in small towns, and in some countries (mainly in Slovakia, Hungary and Romania) the roma population whose jobs were mostly in the collapsed metal and building industries.

3.10 How transition influenced the Eastern European Social Model

As Western Europe has no unified social model, the East European countries also have had their specialities; however, there are some similarities. For instance, full employment was seen as an obligatory task of the state, everybody could and should be employed. The compressed income satisfied a modest living standard, which actually improved during the 1950s and 1960s. Supported by the fast economic growth (which was the result of the industrial

development within the framework of COMECON cooperation) the social security system widened. Health care was gradually extended to the whole of society: free health care became a citizen's right. The pension system improved as well. By the 1970s, everybody over the pension age could get some kind of pension or some kind of government support. These were supplemented with a social benefit system which – for instance – supported families with children, provided accommodation to young couples and so on.

However, in the individual counties the practice was different. Probably in the best position – at least in the 1970s – was Hungary where – as a consequence of the economic reform in 1968 – the supply of products was relatively abundant and citizens were allowed to travel to the West, which was a privilege in the Warsaw Pact countries at that time. In other countries one of these components was sometimes lacking. For instance, there were problems with the supply of goods (Poland, Romania) or with the right to travel (East Germany). Even the guaranteed rights were sometimes difficult to reach. For example, young couples entitled to new flats had to wait a long time (sometimes ten years or more) until they were able to move into their new homes.

By the 1980s, the basis of these social provisions deteriorated. Economic growth slowed down and some countries (like Hungary, Poland and Romania) ran into severe foreign debt. The society began aging, the number of pensioners increased and the number of people of working age decreased. Social provisions became more costly, especially in the field of health care where new innovations multiplied the expenses.

When the systemic change began the social model was already under great economic pressure and this pressure increased with the liberalisation and privatisation of the economy with the impact that the old economic structure collapsed, producing a tremendous loss in jobs and social contributions. The dual character of most of the CEE economies is also a source of uncertainty, because the relocation of the big multinational firms, or the repatriation of their income, might influence the host country's economy in a substantial measure.

There is another social phenomenon which is also a consequence of the breakdown of local industries and this is the disintegration of the local communities. The workplace is not only for earning income; it is also a place where people meet each other and establish social connections. With the diminishing number of jobs and the smaller and smaller production units these kinds of social connections have also dwindled giving room for the emergence of a deprived debris society.

3.11 Summary

By the late 1980s the ideological strength of communism had faded; successive economic crises strengthened the feeling in the CEE countries that something was wrong with the system and that substantial changes were

needed. With the weakening of the Soviet Union, the time came for change. The systemic change in all of the CEE countries was carried out with the aim of establishing a democratic (multiparty) political system and of replacing the planned economy with an economy based on market principles. To reach this goal the CEE countries liberalised and deregulated their economies and privatised the companies that had previously been in state ownership. Although there are substantial differences among countries, as a general phenomenon it can still be said that the economic reforms – influenced by the ruling neoliberal economic ideas – have produced controversial results. On the one hand, the economy of the CEE countries, after a severe fall-back, began to grow at a rather high rate, much above the EU average, and its effectiveness improved. On the other hand, it was mostly the impact of multinational companies which bought up the privatised companies or relocated their production in these countries. Local industries lost ground and as multinationals and other investors began to draw out their profit or income the current account balance of these countries started to deteriorate further, which – accompanied with the world financial crises – pushed some countries (Hungary, Latvia) to the brink of insolvency by the end of 2008.

Most of the people in these countries thought that the systemic change, the democratic political system and the market economy would result in a fast catching up with the living standard of the Western European countries. However, this hope became a reality only for a limited number of people, mainly for those who were the winners in the privatisation. For a large part of the society the systemic change – against the improvement in supply of goods or the free movement of labour – brought uncertainties and deteriorating life conditions, which is especially true for the central European roma population who were the greatest losers in the collapse of the traditional industries.

Against the fact that the direct goals of the systemic change – democracy, market economy, private ownership of production means – has been realised, twenty years after the systemic changes most of the CEE countries have to face economic disturbances and the hope of catching up with the Western world is postponed to the distant future.

Notes

1. Nikolai Aleksandrovich Semashko was a Russian communist who was the People's Commissar of Public Health between 1918 and 1930.
2. World Bank database, http://devdata.worldbank.org/data-query/ (Accessed 28 January 2009).

References

Bennett, J., Eskrin, S., Maw, J. and Urga, G. (2004) *Privatisation Methods and Economic Growth in Trasnsition Economics* (Manuscript, March. CEPR Discussion Paper No. 4291).

Eurostat (2009) Direct investment stocks as % of GDP, http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database
Filip, Codruta-Liliana (2007) Privatization Experience in Romania. Liberalization, Privatization and the European Social Model (Manuscript written for PRESOM).
Kocenda, Evzen and Svejnar, Jan (2003) Ownership and Performance After Large-Scale Privatization (William Davidson Institute Working Paper No. 471a, January), http://ssrn.com/abstract=401620 or DOI: 10.2139/ssrn.401620
Mitra, P-Yemtsov, R. (2006) Increasing Inequality in Transition Economies, Is there More to Come? (World Bank Policy Research Working Paper 4007, September).
Štiblar, Franjo (2007) Privatization of Financial Sector in Transitions Countries: What Went Wrong and How It Should Be Done (University of Ljubljana, and Economic Institute of School of Law [EIPF]).

4
Finance as Driver of Privatisation

Jörg Huffschmid

4.1 Introduction

This chapter deals with the particular role which finance plays as a driver of privatisation. The thesis is that during the last two decades private and public finances have moved in opposite directions and generated specific pressures, for which privatisation of public goods and services appears as a solution. The accumulation of private financial assets creates pressure to find more investment opportunities, and the political bias for balanced budgets and tax competition leads to pressure to cut expenditure in public services, which appear increasingly unaffordable. Privatisation offers both relief for public budgets and opportunities for private asset owners. In the course of this development, individual entrepreneurs and the production-oriented management are gradually replaced by financial investors as key actors of capitalism which can therefore be characterised as finance-led capitalism.

The chapter is organised as follows: Section 4.2 presents empirical data for the accumulation and internationalisation of financial assets, the historical causes for this development and a very brief outline of the framework for finance-led capitalism. Section 4.3 deals with the main groups of financial investors and section 4.4 with pressures on public budgets. In section 4.5 the role of financial investors in privatisation in the narrow sense of ownership change and in the broader sense of commercialisation of public services are discussed. Section 4.6 concludes with some deliberations about the consequences of the recent financial crisis for finance-led capitalism in general and the prospect of privatisation in particular.

4.2 Accumulation and internationalisation of financial assets and the emergence of finance-led capitalism[1]

Mega-trends Two mega-trends have shaped global financial markets during the last three decades. The first is the extraordinary growth of worldwide financial stocks (WFS) – equities, corporate and government debt securities

and bank deposits. They rose from $12 trillion in 1980 to $167 trillion in 2006, that is, by a factor of 14. During the same time global gross domestic product (GDP) grew only from $10 trillion to $48 trillion, a factor of 4.8. In 1980 nominal GDP and WFS were of about the same size; by 2006 the latter had become three and a half times larger than the former (see Farrell, Fölster and Lund, 2008, p. 3). Since financial assets are held with the claim to generate profits for their owners, the fact that these claims grew much stronger than worldwide GDP – as the ultimate basis for profits – poses an obvious problem.

The second mega-trend is the *internationalisation* of financial assets, which also developed much faster than global GDP. During the 1970s the amount of internationally invested financial stocks corresponded to 50–70 per cent of worldwide GDP; at the beginning of the 2000s this ratio had risen to about 320 per cent for industrial countries and to about 150 per cent for developing countries and emerging markets (see Lane and Milesi-Ferretti, 2006, p. 35).

Causes There are mainly four causes for these mega-trends. The *first* and probably most important one is the long-term redistribution of income and wealth from the bottom to the top, clearly reflected in the falling wage share in the three centres of capitalism: from 1975 to 2008 it fell by four percentage points (from 70.4 per cent to 66.5 per cent in the USA, by 11 percentage points (from 76.3 per cent to 65.3 per cent) in the EU-15 and by 14.3 percentage points (from 80.1 per cent to 65.8 per cent) in Japan (see European Commission, 2002, Statistical Annex, table 32, European Commission, 2007a, table 32). This increase in inequality is a trend prevailing since the 1970s almost everywhere in the world (see for example Atkinson and Piketty, 2007; OECD, 2008).

The *second* cause is the trend towards capital-funded pension systems, which channelled a larger part of pension contributions to the capital markets, where they are managed by pension funds and insurance companies. At the end of 2007, assets in pension funds ($28.2 trillion) were almost six times higher than in 1992 ($4.8 trillion) (see IFSL, 2008a, p. 8).

A *third* cause for the build-up of financial assets was the relatively generous loan policies of banks. Although credit developed in clear waves along the business cycles, its overall extension was stronger than the overall growth of GDP – and it played a very propelling role in times of financial exuberance and the build-up of financial bubbles like the one of 2007–2008.

The *fourth* factor was the liberalisation of capital movements after the end of the Bretton Woods system in the mid-1970s (see Eichengreen, 1996, chapter 5).

These four factors were not a reflection of the ‘iron laws’ and an inevitable ‘logic of capital’. Rather they were the result of changing social power relations (wage share) and political decisions (pension reform and liberalisation of capital accounts), which in turn were responses to economic and political pressures.

Finance-led capitalism The extraordinary long-term accumulation and internationalisation of private financial assets has changed the quantitative proportions between the financial and the productive sectors of the economies and has led to a shift of the main driving actors and bottlenecks of capitalist development towards a more finance-driven pattern.

Until the 1970s, the driving actors in capitalist development were individual *entrepreneurs* or *managers* whose work was concentrated on the production and sales side of their companies. External finance was a bottleneck for corporate investment and economic development. This bottleneck was overcome through household savings and credit creation by the banking sector which was politically supported by the central banks.

By contrast, in mature capitalist economies there is an abundance of financial assets for which profitable investment opportunities are becoming increasingly scarce, while at the same time credit creation continues on a large scale as the source of profits for the banking sector. Under these circumstances, *financial investors* replace individual or corporate entrepreneurs as leading actors in development. They collect and centralise large amounts of money from the ultimate asset owners and invest them in a broad range of activities of which production of goods and services is only one option – speculation, mergers, privatisation and so on are others. Capitalism becomes finance-led capitalism, at least in the developed centres.

The transition to this pattern of finance-led capitalism is a gradual process which started 30 years ago and it is not yet terminated. In a narrow economic perspective, it is the way capital deals with a new pattern of financial over-accumulation different from the traditional one (underutilisation of existing capacities). In a broader political perspective, it should be regarded as a rollback against the success and achievements of progressive reform-policies in the two decades after World War II.

4.3 Financial investors

Financial assets under professional management amounted to $110 trillion at the end of 2007. More than two thirds of these ($74 trillion) were managed by institutional investors, one fourth ($27 trillion) by banks, endowments, foundations and so on and 7 per cent ($8 trillion) by 'alternative' investments, that is, hedge funds, private equity and sovereign wealth funds (IFSL, 2008a, p. 7).

4.3.1 Institutional investors

Institutional investors are subdivided into three large groups: investment (or mutual) funds ($26 trillion), insurance ($20 trillion) and pension funds ($28 trillion). Their structures differ strongly across countries: While in France only 3.8 per cent of all conventionally managed funds were in pension funds, this category covered 62.2 per cent in the Netherlands. In Germany more than two thirds of assets (66.8 per cent) are managed by insurance companies,

Table 4.1 Sources of global assets under conventional management, end of 2007

	Pension funds		Insurance assets		Mutual funds		Total		
	trns $	**%**	**trns $**	**%**	**trns $**	**%**	**trns $**	**%**	**% of total**
US	17,205	48.4	6,324	17.8	12,012	33.8	35,514	100	47.9
Japan	1,083	23.4	2,839	61.2	0,714	15.4	4,636	100	7.5
UK	3,161	45.4	2,862	41.1	0,945	13.6	6,968	100	11.3
France	0,167	3.8	2,230	50.8	1,990	45.4	4,387	100	7.1
Germany	0,563	20.0	1,880	66.8	0,372	13.2	2,814	100	4.6
Netherlands	0,999	62.2	0,493	30.7	0,114	7.1	1,606	100	2.6
Switzerland	0,491	46.3	0,395	37.2	0,176	16.6	1,061	100	1.7
Other	4,463	26.0	2,813	16.4	9,877	57.6	17,153	100	27.8
Total	28,132	37.9	19,836	26.8	26,200	35.3	74,139	100	100

Source: IFSL (2008), p. 8; own calculations

which in the USA account for less than one fifth (17.8 per cent) (see Table 4.1). About half of the assets under institutional management come from the USA, slightly more than one tenth from the UK (see IFSL, 2008a, p. 7).

Institutional investors have developed steadily until the end of the last century, and their assets have massively increased during the last years. This growth has made it more difficult to generate the attractive returns necessary to retain their customers (the ultimate money-owners) and maintain or enhance their competitive position in the markets. Such difficulties have created space for financial innovations and innovators, which have started to change the reach and impact of financial investors, with considerable consequences for the thrust for privatisation – in the narrow sense of change of ownership and in the broader sense of transfer of services into a framework of competition. Most prominent are private equity firms who open up new areas for financial investment and hedge funds who introduce new strategies and benchmarks in corporate governance.

4.3.2 Private equity

Private equity firms are undertakings who collect money from banks, pension funds and 'high net worth individuals' (HNWI), borrow additional resources from banks, use the money to buy firms, restructure them and sell them with high profits either on the stock exchange, or to strategic investors or to other private equity firms.

Worldwide private equity investment developed in an unsteady way during the last ten years: it rose steadily from $60 billion in 1996 to $200 billion in 2000, then dropped sharply to less then $100 billion in 2001, and picked

up slowly from 2002 to 2005. In 2006 and 2007 it virtually exploded and reached $686 billion, this is three times the value of the last peak in 2000 (see IFSL, 2008c, p. 1). Assets managed by private equity firms rose to $2 trillion in 2007 (see IFSL, 2008a, p. 7). Only in 2008 the worldwide financial crisis made itself in the private equity sector: funds raised and investment fell dramatically.

The extraordinary rise of private equity investment during 2006 and 2007 is partly because these years saw a number of mega-deals which have until then been rather the exception. Of the 10 largest transactions since the end of the 1980s, eight were carried out in 2006 or 2007 (see IFSL, 2008c, p. 4) during the build-up of the recent speculative bubble, when credit was cheap. Although the large majority of private equity firms is of US origin Europe is catching up, increasing its share of funds raised from 21 per cent to 24 per cent and of investment from 21 per cent to 24 per cent between 2000 and 2006 (IFSL, 2007, p. 6).

4.3.3 Hedge funds

Hedge funds are assets which come from HNWI and banks, and increasingly also from institutional investors (particularly pension funds), and they are invested in high-profit – high-risk securities (*financial speculation*) or in quoted stocks where they develop *shareholder activism* to generate high dividend payments or to enhance market capitalisation or to boost takeover prices. It is estimated that currently there are about 11,000 hedge funds with about $2.25 trillion of private money (see IFSL, 2008b, p. 9). This figure appears small in comparison to the $74 trillion managed by 'traditional' institutional investors. But hedge funds operate on a highly leveraged basis and with $225 trillion private capital can invest about ten times this amount, that is, about $225 trillion. This is about the same size as each of the three groups of institutional investors represents.

The majority of hedge fund assets is still of US origin. However the US share declined from more than four-fifths (82 per cent) to just over two-thirds (67 per cent) between 2002 and 2007. Europe is rapidly catching up, with an increase of its hedge funds asset share from 12 per cent to 22 per cent during these five years (see IFSL, 2008b, p. 1). More than half of all hedge funds (57 per cent) worldwide have their legal domicile offshore (mostly on the Cayman Islands) and of those domiciled onshore about one-half (48 per cent) is registered in the US (mostly in Delaware).

4.4 Pressures upon public finances

In contrast to the pressures of abundant private financial assets to find profitable investment opportunities, we observe on the public side increasing pressure on budgets and public expenditure. This is mainly the result of two developments.

The first is the persistently high unemployment, together with low wages and increasing precariousness and poverty. These lead to lower public revenues from income taxes and social contributions, and to higher needs for social expenditure for unemployment and welfare benefits. Such pressures would normally result in higher public expenditure, which could be financed either through higher taxes on non-labour income or through public deficits. The reason why this did not happen and the second factor of budgetary pressures in the EU is the specifically narrow and fundamentalist macroeconomic policy position of the EU institutions, with the 3 per cent limit on public deficits codified in the Maastricht Treaty of 1992 and reinforced in the Treaty of Amsterdam and the Stability and Growth Pact in 1997. At the same time, under pressure of neo-liberal tax competition between member states, corporate tax rates were considerably lowered. Although the full effect of this was partly compensated by the broadening of the tax base so that the weight of corporate tax revenue in total revenue remained constant, this amounted to a considerably lower taxation of profits, because their weight in total incomes had risen considerably during the last decade.

The result of this constellation in the EU-15 was a fairly constant share of public revenue, and a decreasing share of public expenditure, resulting in a reduction of public deficit from an EU-15 average of 5 per cent in 1995 to 1 per cent in 2008 (see European Commission, 2007a, tables 70, 73, 74).

Ironically, the obsessive reduction of public deficit has at the same time narrowed an important and safe channel of absorption for private financial assets, in the first place for pension funds and other institutional investors who are looking for safe investment opportunities like government bonds.

4.5 Financial investors and privatisation

In the framework of growing private financial assets seeking investment opportunities and at the same time growing pressures upon public finances, privatisation appears as a solution to the problems of both the wealthy and the state: It gives the former a new area for investment and relaxes the financial burden for the latter. On the one hand, governments can no longer afford to maintain the level of public services because tax reductions on profits and on high incomes diminish public revenue and the Stability and Growth Pact restricts public debt and deficits. On the other hand, the same tax reductions raise the net incomes of the beneficiaries at the top of the social pyramid. They use the additional money to take over from the government public services to transform them into a source of private profits. In a net calculation the procedure amounts to a gift to the top: Governments provide financial resources to financial investors and then sell them public assets in exchange for these resources. The result is the transformation of public welfare into private wealth.

However, it remains an open question whether this privatisation of public services under fiscal pressures fulfils its purpose to reduce the fiscal burden for the state. This is obviously the case when together with privatisation public responsibility for the maintenance of the previously public service is abandoned – with the accepted consequence of a deterioration in the quality, affordability, accessibility and so on of such services. In cases where governments privatise services but maintain the commitment to provide them as public mission (organised via public regulation or Private Public Partnerships – PPPs) the costs of regulation or of buying or leasing facilities and services from the private sector will, in a long-term perspective, often be higher than public provision financed through public loans (see Shaoul, Stafford and Stapleton, 2008).

4.5.1 Private equity and privatisation

Until the beginning of the current decade private equity funds were not particularly active on the buyer side of privatisations. Reasons for their reluctance were 'government scepticism towards privatisation' and 'regulatory constraints imposed in many privatisations', among others. This is particularly true for the privatisation of large state-owned corporations in tariff-regulated industries or in 'sectors with stringent employment level constraints' (like utilities or former municipalities) (Levantini, 2007, pp. 20–21). Only when the regulatory framework was relaxed in the EU, private equity became strongly involved in privatisation.

In 2006 this involvement reached its peak: In 5 out of 59 large transactions with a total value of €40.4 billion, private equity firms (PEF) were on the buyers side, paying a total amount of €10.4 billion, that is 25 per cent of all privatisation revenues (see Table 4.2 and Levantini, 2007, p. 9).

Table 4.2 PEF in privatisations in 2006

Country	Company	% Sold	Price €bn	Buyer
Germany	Deutsche Telecom	4.5	2.68	Blackstone
	Woba Dresden	100	1.63	Fortress
	HSH Nordbank	24.1	1.27	Christopher Flowers
France	Pages Jaunes (France Télécom)	54.0	3.31	KKR
Netherlands	AVR Bedrijven (City of Rotterdam)	100	1.41	CVC Capital Partners
Total			10.3	

Source: Privatization Barometer (2006, 2007)

4.5.2 Hedge funds and commercialisation

Shareholder activism by hedge funds with the aim of quick and large cash flows has severe consequences for privatisation in the broader sense of imposing a commercial framework and profit orientation upon service providers, privatised or not. These consequences do not only relate to the firms immediately affected through hedge funds pressure. At least as important and overall much more dangerous is the threat of *systemic contagion*. It is the proliferation of the aggressive strategies of hedge funds to traditional institutional investors which are the main pillars of the management of financial assets.

This mechanism of contagion is because institutional investors are private firms which compete for the money of their clients as ultimate asset owners. A fund which has invested the assets in a stock company with a long-term perspective sees the profits (and its own earnings) rise when hedge funds invest in the same company and force the management to generate and distribute more short-term cash flow to the shareholders. The fund as one of these shareholders benefits from this aggressive strategy although it did not apply it itself. Higher returns for this fund exert pressure on all other institutional investors to generate equally large and quick cash flows. Thus, aggressive strategies of a minority of investors establish standards and benchmarks for all institutional investors and via spillover effects on the economy at large.

This has severe consequences for the management of privatised service providers. In sectors like utilities and telecom, it becomes increasingly difficult to fulfil the universal service obligations under the pressure of financial investors to maximise short-term returns. The balance between profits and public service commitment – which regulatory authorities try to maintain – will be heavily pushed towards the profit side. If regulation prevents this by strict intervention shareholders will quit and market capitalisation will dramatically fall. In such an emergency case it will normally be the employees who have to pay the price first for keeping the company in business. The conception that high service quality and high profits in network industries can permanently coexist – that is the core official rationale for privatisation of public network services – will be undermined and destroyed under the enhanced pressure of a new generation of financial investors to generate maximum profits in minimum time.

4.5.3 Financial investors and the privatisation of pension systems

A particularly problematic link exists between financial investors and the increasing privatisation of pension systems during the last two decades. Two points are of importance here.

First, the financial industry – supported by international institutions like World Bank and OECD – has exerted strong pressure for 'pension reform'

that is the partial or complete transformation of public PAYG into private capital funded systems. The strong growth of pension funds during the last decade is the result of this trend.

The theoretical and political justification for a shift from public PAYG to private capital funded systems has been the ongoing demographic change towards societies with a larger part of retired persons. These changes allegedly make it impossible to maintain the traditional systems and require additional individual savings. It has been shown that such arguments are untenable (see for example Baker and Weisbrot, 2000; Eatwell, 2003; Minns, 2001). An increase of the share of elderly persons in the population requires – if their relative living standard is to be maintained – that a larger share of goods and services produced at the time of their retirement must go to the pensioners, regardless of how this is organised – through rising contributions of the active part of the population or through more individual savings by the pensioners before their retirement. Comparisons between the two – theoretically equivalent – systems have also shown that capital funded systems are less reliable (because of their linkage to the risks of financial markets), less comprehensive (because they do not cover periods of sickness or parental leave and so on) and much more expensive (because of the marketing costs and profit claims of competing pension funds).

If in spite of these facts the propaganda and thrust for further privatisation of pension systems continues, this is a strong indicator not only for the interests of the benefiting financial investors but also for their power to impose this interest upon society (see Wehlau, 2009). The reason for this interest was not the lack of financial assets in general but the endeavour from the part of the financial corporations to collect ever-larger amounts of capital to establish strong and dominant positions on the financial markets. Pension funds as the largest single group of institutional investors do not get their money from millionaires but from employees, but they are managed – in Europe more than in the US – by off-springs of large financial corporations like Barclays, ING, Allianz, Axa, Deutsche Bank, UBS and so on.

The second point is the alarming fact that during the last decade pension funds have been increasingly dragged into high-risk financial speculation. Already the dot.com crisis of 2001/2002 destroyed the income and living standards of employees of Enron and WorldCom. In the meantime, the momentum of speculative investment has increased. It should be alarming that the share of assets which pension funds invest in hedge funds to enhance their returns has risen from 10 per cent to 14 per cent during the last decade (see IFSL, 2008b, p. 2). On the one hand, this exposes the pensions of employees increasingly to the risks of financial markets. On the other hand, it enhances the pressure from the part of pension funds upon the management of the firms in which they invest to generate greater profits; and this translates into greater pressure on the employees of these firms to work more for less money and on the state to cut social expenditures.

The recent financial crisis has clearly demonstrated the insecurity of pensions which are dependent on financial markets. In the UK, the Netherlands and Sweden heavy losses have been reported in the assets of pension funds. For instance 'employees investing for retirement through defined contribution pension arrangements have seen the value of their assets fall by £157 bn (€194 bn) or over 28 per cent in the last 12 months' and "it will now take 'a long time' to bring investments back to the level of investments and returns seen last year" (IPE, 2008, p. 1).

4.6 Outlook: The impact of the financial crash on financial investors and privatisation

What are the perspectives for privatisation after the financial crisis which started in 2007 and its impact on financial investors? On the one hand, these have been seriously affected by the fall in equity prices and banking crisis. The value of their investments has drastically fallen and caused large losses to institutional investors. This is a big problem for pension funds, particularly for the employees who are entering or approaching retirement age and whose living standard will be directly reduced. Furthermore, the market for credit to finance large takeovers has practically dried up. The time of big leveraged deals seems to be over. This is a market correction which is appropriate for the economy, harmless for institutional investors, but it is painful for private equity and hedge funds and their clients. Without the credit lever the rate of return of capital would fall considerably. Finally, if the declared intentions of governments and international institutions to regulate financial markets in a much tighter framework materialises – which is not sure – it would become more difficult for hedge funds to engage in speculative activities like short selling or trade in loan packages. This all will exert a dampening effect on financial speculation.

On the other hand, experience shows that the deep financial crisis of 2001 was followed – after two years of slow-down – by a new recovery of financial investment which exploded into new record volumes and record leverage in the years 2006 and 2007. The same could happen again. Low asset prices are an incentive to those who still have money to buy cheap shares, which would in the end lead to a higher degree of concentration of asset ownership – and of economic and power and political influence of the winners of the crisis. Investment banking has not disappeared with the demise of the US investment banks; rather it has been integrated into universal commercial banks which could create new dangers for the ordinary retail business of these banks.

Thus, the financial crisis does not lead to the end of finance-led capitalism. As long as the underlying causes of the over-accumulation of financial assets is not addressed, the pressure will remain to organise ever higher profits for these assets. New financial market regulations will possibly have the

positive effect of containing financial speculation. At the same time it will drive financial investors into other directions of investment. In this context the pressure for privatisation opportunities may even become sharper than before. It is well conceivable that the usual short-term horizon of the new financial investors is extended and prolonged, for instance through the growth of infrastructure funds (see Hall, 2006). As long as the trend for upwards redistribution of income and wealth, and the thrust for shifting pension systems towards capital-based systems are not stopped and reversed, public services will remain an object of desire on the part of financial investors.

Note

1. For a more detailed analysis, see Huffschmid 2008.

References

Atkinson, A. B. and Piketty, T. (eds) (2007) Top Incomes over the Twentieth Century. A Contrast Between Continental European and English-Speaking Countries (Oxford: Oxford University Press).

Baker, D. and Weisbrot, M. (2000) Social Security: The Phoney Crisis (Chicago, IL: University of Chicago Press).

Eatwell, J. (2003) The Anatomy of the Pension "Crisis" and Three Fallacies on Pensions (London), www-cfap.jbs.cam.ac.uk/publications/files/Eatwell-pensions crisis.pdf

Eichengreen, B. (1996) Globalizing Capital. A History of the International Monetary System (Princeton, NJ: Princeton University Press).

European Commission (2002) European Economy, No. 6.

European Commission (2007a) Economic Forecasts, Autumn 2007, Statistical Annex U (Brussels).

European Commission (2007b) Statistical Annex of European Economy.

Farrell, D., Fölster, Ch. S. and Lund, S. (2008) Long-Term Trends in the Global Capital Markets (The McKinsey Quarterly, Economic Studies, February).

Hall, D. (2006) Private Equity and Infrastructure Funds in Public Services and Utilities (London: PSIRU), www.psiru.org

Huffschmid, J. (2008) "Finance as a driver of privatisation", Transfer, 14 No. 2, pp. 209–236.

IFSL Research (IFSL) (2007) Private Equity 2007, (London, August 2008), www.ifsl.org.uk

IFSL Research (IFSL) (2008a) Fund Management 2008 (London, October 2008), www.ifsl.org.uk

IFSL Research (IFSL) (2008b) Hedge Funds 2008 (London, July 2008), www.ifsl.org.uk

IFSL Research (IFSL) (2008c) Private Equity 2008 (London, August 2008), www.ifsl.org.uk

Investment and Pensions in Europe (IPE) (2008) DC members see pensions drop over a quarter, www.ipe.com/articles/print.php?id=29538

Lane, Ph. R. and Milesi-Ferretti, G. M. (2006) The External Wealth of Nations Mark II: Revised and Extended Estimates of Foreign Assets and Liabilities, 1970–2004 (IMF Working Paper WP/06/69, Washington).

Levantini, A. (2007) "The Role of Private Equity Funds in Global Privatizations", Privatization Barometer Newsletter, No. 6, www.privatizationbarometer.net

Minns, R. (2001) The Cold War in Welfare: Stock Markets versus Pensions (London: Verso).

OECD (2008) Growing Unequal? Income Distribution and Poverty in OECD Countries (Paris).

Privatization Barometer (2006) Newsletter No. 5.

Privatization Barometer (2007) Newsletter No. 6.

Shaoul, J., Stafford, A. and Stapleton, P. (2008) "The Cost of Using Private Finance to Build, Finance and Operate Hospitals", *Public Money and Management*, Vol. 28, No. 2, pp. 101–108.

Wehlau, D. (2009) Lobbyismus und Rentenreform. Der Einfluss der Finanzdien stleistungsbranche auf die Teil-Privatisierung der Alterssicherung (Wiesbaden: VS Verlag für Sozialwissenschaften).

5

Theoretical Approaches to Explaining and Understanding Privatisation

Malcolm Sawyer

5.1 Introduction

The central purpose of this chapter is to review a number of distinct theoretical perspectives which come from the economics and political economy literatures on issues of privatisation and liberalisation. The chapter begins by a consideration of the Austrian approach and the property rights literature and their approaches to markets, private property and competition. This broad approach is the one which most unambiguously promotes the roles of private ownership, competition and unfettered markets, and this is followed by an examination of the neoclassical approach. The neoclassical economics approach is broadly interpreted here and agency theory is encompassed within that approach. The manner in which the neoclassical economics approach addresses issues of competition and privatisation are evaluated. The widespread shift from public ownership to privatisation in the past three decades or so (in, for example, public utilities) raises the question of whether there are convincing explanations based on economic analysis for that shift. The contribution of the Austrian and neoclassical approaches to possible explanations are explored. The notion of efficiency involved in the discussion of privatisation is briefly considered particularly since privatisation is often advocated for its claimed favourable effects on efficiency. The last main section outlines the political economy of privatisation and liberalisation, with an emphasis on the roles of profits, accumulation and finance in the promotion of privatisation.

5.2 The Austrian approach and property rights

The Austrian approach amongst others has long stressed the significance of private property for the pursuit of profits, but within the context of competition and rivalry, and argued that efficiency of production comes from that pursuit of profits.[1] The Austrian approach views competition as a dynamic process taking place against a background of change and uncertainty. The

pursuit of profits by entrepreneurs, it is argued, will lead on the one side for the entrepreneurs to press for lower costs in their production processes and on the other side for them to seek out new markets and to provide the consumers with what they want (or at least are prepared to pay for). Greater revenues and lower costs would, of course, increase profits. But being able to charge high prices would be constrained by competition. Hence the existence of profits, particularly high profits, is seen as an indicator that the firms concerned are particularly efficient both in terms of productive efficiency and of producing goods which consumers wish to buy. In particular, high profits are not seen as associated with market power, though there may be an association between high market shares and profits. But the link is not from high market share indicating monopoly to high profits, but rather that above-average efficiency generates a high market share and large profits.

It is the threat of new entry into an industry which keeps the incumbent firms on their toes. This leads to an emphasis on the importance of entry conditions into an industry, rather than the number of firms in the industry. One firm in an industry may appear to be a situation of monopoly, but if there are a number of firms ready to enter that industry if the existing firm allows its prices to rise above their level of costs then the incumbent firm is highly constrained in its pricing.

An important element of the Austrian approach is the importance of property rights and the role of the entrepreneur in exploiting profit opportunities. If the entrepreneur is to seek after profits, then he or she must have the claim to the profits generated, and hence, it is argued, the property rights to the profits must be assigned to the entrepreneur. The single entrepreneur is seen to be willing to take risks, to strive for lower costs and so on, because he or she will be the beneficiary of any resulting profits. In an organization with a large number of owners, the link between effort and profits is much diluted. The essential difficulty of nationalised industries, workers' co-operatives and also of large manager-controlled corporations is seen to be that ownership is dispersed amongst a very large number of individuals.

The Austrian approach places great emphasis on the role of the entrepreneur in a market situation seeking out new opportunities and undertaking innovations. The market process is viewed as one of discovery, as entrepreneurs compete against one another. The outcome of the competitive process cannot be predicted. This raises difficulties for regulation of public utilities. "Many commentators ... have asserted that the purpose of utility regulation, and of price caps in particular, is to mimic the operation of the competitive market. I myself have never claimed that. I agree with Mises about the difficulty of predicting what a competitive market price could be, particularly in markets characterised by heavy capital investments that are location-specific and have long asset lives" (Littlechild, 2000, p. 13).

The Austrian approach would strongly support private ownership over public ownership on the grounds of the allocation of property rights which

leads to owners having incentives to pursue profit opportunities. It also plays down the need for any regulation of an apparent monopoly position or industry operating with economies of scale. A leading exponent of the Austrian view (and one closely involved with UK privatisation and subsequently regulation) wrote in the following vein:

> what are we to make of the Austrian view of utility regulation? There seems to be a general consensus that monopoly is not as widespread or permanent or problematic as generally believed; that such monopoly as does exist is most likely attributable to government restrictions; that regulation of potentially competitive markets is likely to produce shortages or be counter-productive; and that a little intervention is likely to breed more. … Government ownership of utilities is considered to be undesirable because it is likely to be loss-making or too powerful, and likely to prolong the monopoly (Littlechild, 2000, p. 15).

The role of competition is stressed, for example: "Competition is the most important mechanism for maximising consumer benefits, and for limiting monopoly power. Its essence is rivalry and freedom to enter a market. What counts is the existence of competitive threats, from potential as well as existing competitors. The aim is not so-called 'perfect' competition; rather, one looks for some practical means to introduce or increase rivalry" (Beesley and Littlechild in Beesley, 1997, p. 29). The implication to be drawn from statements such as this is that any restraints by government on competition and on firms entering an industry should be reduced or removed. The link between privatisation and liberalisation is then made by arguing that competition can be more readily generated when there is private ownership rather than public ownership. For example, "some have argued that ownership is largely irrelevant. But could the benefits of privatization be obtained without the change in ownership? We have already argued that ownership *does* matter because consumers in general will be better served. Also, for political reasons, privatization may be a necessary accompaniment to competition. … Furthermore, competition policy is (or certainly could be) more effective against a private company than against a nationalized industry" (Beesley and Littlechild in Beesley, 1997, p. 29).

The general line of argument which comes from the Austrian approach can be linked with the literature on property rights. The economics of property rights argues for the importance of well-defined and objectively enforceable property rights to make contracting possible without which exchange and trade would be difficult. Contracts are necessarily incomplete because of uncertainty about the future and the inability of individuals to envisage all possible futures and to process information ('bounded rationality'). Actors aim at minimising the risks of post-contractual opportunism and the theory of property rights then explains that the owner of the rights has control

over the way how the incompleteness is filled in at a later stage. The ways in which property rights are allocated becomes crucial for the ways in which trade and exchange are conducted and for the incentives which prevail. The allocation of property rights largely determines the incentives structure. The owners can have the right to use, to manage and to alienate the property. Property rights can be different from decision rights: the owner can give decisions rights to another party (in the case of leasing, or renting), or the decision rights can be limited through laws and regulation.

With respect to the issue of privatisation the theory of property rights focuses on the incentives related to the type of property rights. Private property rights are generally considered to be efficient because individuals negotiate in contracting processes on the exchange of property rights and individuals seek to pursue their own interests. In case of state-owned property the theory predicts large bureaucratic inefficiencies as the state acquires the property rights but those exercising decisions do not have property rights specifically with regard to benefits and profits generated by their decisions. In case of common property (the so-called 'tragedy of the commons') each individual will maximise her or his profits by letting more sheep graze on the common, or fishing more fish out of the sea. By maximising individual profit the 'common' is destroyed. So in that case the theory of property rights explains the necessity of a set of rules that preserve the common.

It is argued that it is individuals who pursue their own interests in the context of property rights. In the case of collective property rights, since an individual member of the collective would receive little if any reward from the pursuit of the profits of the collective, there is little incentive to pursue those profits. Many of the arguments for privatisation are based on the theory of property rights on the basis that under privatisation property rights will be allocated to individuals who will pursue the highest rewards to the property. But under privatisation, the property rights remain collectively owned, now by numerous shareholders.

The general case for privatisation from this general perspective is well summarised in the following:

> Privatization will generate benefits for consumers because privately owned companies have a greater incentive to produce goods and services in the quantity and variety which consumers prefer. Companies which succeed in discovering and meeting consumer needs make profits and grow; the less successful wither and die. The discipline of the capital market accentuates the process: access to additional resources for growth depends on previously demonstrated ability. Selling a nationalized industry substitutes market discipline for public influence. Resources tend to be used as consumers dictate, rather than according to the wishes of government, which must necessarily reflect short-term political pressures

> and problems of managing the public sector's overall demand for capital (Beesley and Littlechild in Beesley, 1997, p. 28).

The Austrian approach has always championed private ownership over public ownership (and more generally any forms of social ownership), and viewed barriers to competition as arising from government intervention rather than from economies of scale and activities of incumbent firms. In the Austrian view, private ownership is inherently more efficient than public ownership: the key argument in their approach is the identification of a 'residual claimant' who has the interest of maximising the residual (that is profits). In seeking to maximise the residual, costs are minimised, and in that sense efficiency is pursued. In the Austrian view any firm which does not have a well identified residual claimant will not operate in an efficient manner. The natural monopoly argument is not given a great deal of weight as a rationale for government intervention. Even if economies of scale are strong enough leading to a dominant firm in the industry concerned, the Austrian approach stresses the competitive pressures which arise from the possibility of other firms entering the industry if the incumbent becomes inefficient.

Government policy should then be focused on ensuring that no impediments are placed in the way of new entrants. The public ownership of natural monopolies often includes the exclusive rights to operate in the industry concerned. The Austrian approach would stress the change of ownership from public to private and also the removal of any barriers to entry. The Austrian approach would also stress the difficulties involved in regulation of utilities arising from problems of 'agency capture' (regulator operating in the interests of the producers), issues of information and 'government failure', the subjective nature of costs and the inherent difficulties of replicating a competitive market. One summary of this position is given by "when technical conditions make monopoly the natural outcome of competitive market forces, there are only three alternatives: private monopoly, public monopoly, or public regulation [of private monopoly]. ... All three are bad so we must choose among evils ... I reluctantly conclude that, if tolerable, private monopoly be the least of the evils" (Friedman, 1962, p. 28).

The Austrian approach would seek to explain the shift to privatisation in the past quarter of a century in terms of the 'triumph of ideas'. The advocacy of privatisation by that approach has been unchanging and not related to the economic, political or material circumstances. For the form of privatisation, the shift to private ownership would be seen as the key element with little need for regulation of the private industry (other than ensuring that there are not limits on entry of firms into the industry concerned). Any regulation (notably over prices) should be limited in time until the barriers to entry can be removed.

5.3 Neoclassical economics and privatisation[2]

At one level neoclassical economics could be viewed as taking a neutral stance on the issue of ownership whether public, social or private. The objectives pursued by a firm would impact on the decisions which it made with regard to price, output, employment, investment and so on. But the objectives set for say managers of a publicly owned firm could, if required, mimic those of managers of privately owned firms, leading to essentially similar outcome. Indeed, neoclassical economic analysis has been used to devise rules for the operation of utilities owned by the state and operating on a natural monopoly basis, for example through ideas of marginal cost pricing or investment decision rules. Within that framework, it is argued that the managers of the public utility could be instructed to follow those rules which are deemed to lead to beneficial outcomes.

Neoclassical economic analysis has long pointed to the conclusion that a situation of monopoly and the pursuit of monopoly profits leads to higher prices and lower output as compared with a comparable situation under a regime of perfect competition. Public utilities appeared as a situation of 'natural monopoly', that is industries where there were extensive economies of scale such that low-cost production would lead to a single dominant firm. Hence a situation of perfect competition (or even oligopoly) would involve more producers, smaller scale of production for each firm and hence much higher costs (as benefits of economies of scale were lost) and indeed perfect competition would be unsustainable as larger firms with lower costs drove out smaller firms. From a neoclassical perspective, public ownership is a possible solution to the 'natural monopoly' problem. Under public ownership the managers of the utility could be instructed to avoid monopoly pricing, and could price according to marginal cost; alternatively if profits maximisation was pursued the monopoly profits would accrue to the state.

From the neoclassical perspective, the arguments for public ownership of utilities and other natural monopolies were undermined in a number of ways. First, doubt was cast on the extent to which there were economies of scale and the degree to which there was an issue of 'natural monopoly' which required solution. This was linked to the second line, namely that even where part of a production process was subject to economies of scale, other parts were not, and those which were not could be operated separately from the other. Hence competition and private ownership could (should) be injected into those parts of the production process which were not subject to economies of scale. This would involve vertical disintegration with different firms being responsible for different stages of the production process. Third, there was perceived to be a strong link between a guaranteed position of monopoly and public ownership. Publicly owned companies were often granted exclusive rights to operate in a particular industry, and hence protected from entry from other firms. The threat of competition for these

publicly owned companies would then be removed leading to such companies being in a soft monopoly position and not needing to pay attention to their cost structures and their productive efficiency.

Neoclassical economics incorporates the notion of 'market failure', which is a rather specific notion of what constitutes failure – in effect a failure of an actual market to mimic perfect competition. The propositions of (neoclassical) welfare economics includes the proposition that a situation of overall perfect competition (which would include price of each product equal to marginal cost) would be Pareto efficient (that is a situation in which there is no way to rearrange things to make at least one person better off without making anyone worse off). One implication of that view is that a monopoly (or more generally oligopoly) situation is one of 'market failure', and the proposed remedy is often along the lines of regulation of the industry's prices in order to mimic the competitive outcome. But a limit on this argument comes from the 'theory of second best' (Lipsey and Lancaster, 1956) which argued that if the 'first best' outcome of price equals marginal cost cannot be attained in one industry, it is not, in general, optimal to seek that outcome in another industry. Hence price regulation of an industry faces the difficulty that following simple rules such as price equal marginal cost may not be desirable in the face of monopolistic and oligopolistic elements in other industries. The implications of the second best arguments are further developed in Chapter 8.

Neoclassical economic analysis had been firmly based on the assumption of technical efficiency, that the technical maximum output was achieved from the factor inputs, and then focused attention on questions of allocative efficiency, that is, the degree to which resources are allocated between different activities in a socially desirable manner. The notion that firms did not typically operate with technical efficiency and that the degree of technical inefficiency varied (Leibenstein, 1966) changed that perspective (though as always it could be questioned whether incorporating technical inefficiency and its causes was consistent with neoclassical economics). This chimed with the frequent popular accusation that publicly owned enterprises were inefficient. Leibenstein did not discuss technical inefficiency with regard to different forms of ownership but he did with respect to competition versus monopoly. The possible link between public ownership and monopoly alluded to above would point towards the relative inefficiency of public ownership. Indeed a number of neoclassical economists have argued that public ownership per se does not lead to inefficiency, but a monopoly position does, leading to the argument that private ownership may be required to enable the break down of a monopoly situation. But it would also point to competition rather than ownership as being the relevant consideration.

Neoclassical economics assumes that (perfect) competition in markets will result in efficient outcomes. When producers are put under competitive

pressure they are then forced to produce at minimum costs (technical efficiency), to produce what consumers want (allocative efficiency) and to innovate new products and production processes whenever possible (dynamic efficiency). If not, they will not survive in the market place.

This is the world of fully rational actors who have sufficient information to calculate ex ante the minimum efficient scale of production. The firm is then a production function and the insight provided to management is 'get the scale of production right'.

From this perspective, markets do not spontaneously result in efficient performance when there are market failures and/or market imperfections. Market failures refer to public goods that is goods where one person's use cannot be prevented (non excludability) and that person's use does not come at the expense of others (non rivalry), to natural monopolies (decreasing marginal costs) and externalities. Imperfection results from abuse of market power. In both cases the recommendation is that government should intervene to correct the failures (produce collective goods, nationalize or regulate natural monopolies and correct externalities that are not corrected by the market itself) and imperfections (competition policies).

The principal-agent problem or agency dilemma arises whenever there is a situation in which one person (agent) is contracted to act on behalf of another (principal) under conditions of incomplete and asymmetric information. The principal wishes the agent to act and behave in the interests of the principal, but finds it costly to specify how the agent should act in a range of circumstances and also finds difficulty in monitoring what the agent does. In the context of private or public ownership, there are many significant principal-agent relations including those involving government (ministry) and state-owned enterprise (and its managers), government (in form of regulatory agency) and private firms, shareholders and managers, managers and employees. Differences in the operations of firms under public ownership and under private ownership then arise from differences in the principal (for example, whether a government department or shareholders) and the objectives of the principal, differences in the relationship between principal and agents and the ability and willingness of the principal to monitor the agents' behaviour and performance.

The neoclassical approach has generally seen public ownership as a response to the 'natural monopoly' problem. It was always recognised that regulation (of prices, profits) of private 'natural monopoly' was an alternative to public ownership. As indicated above the neoclassical approach only favours private ownership over public ownership in so far as the objectives pursued are more conducive to the achievement of allocative efficiency. The neoclassical approach may be able to explain privatisation through the idea that technological changes have changed the extent of 'natural monopoly' (telecommunications may be an example) and hence the need for public ownership as a form of regulation. Another route, which may be debatable

as to whether it would be a neoclassical explanation, would involve changing perceptions of the objectives of public versus private corporations and the effects of those objectives on technical efficiency. The notion of X-inefficiency permitted the discussion within neoclassical economics of the factors which may influence the degree of technical inefficiency, and a favoured line was the role of competition in this regard. The absence of competition in the natural monopoly setting could then be viewed as a cause of technical inefficiency (and hence higher costs).

The neoclassical approach can be seen to have influenced the form of privatisation in two particular respects. First, the structure-conduct-performance paradigm (from industrial economics which can be associated with a neoclassical approach) postulates the relevance of industrial structure including barriers to entry and exit for industrial performance. Second, the nature and form of regulation has been strongly influenced by the neoclassical perspective. The 'natural monopoly' perspective suggested the need for regulation of prices and profits of privatised utilities, at least with regard to those parts of the production process where economies of scale prevailed. The neoclassical approach has generally informed the approach to the precise regulation of prices and costs and the allocation of costs between activities (in contrast the Austrian approach stresses the subjective nature of costs which raises some obvious difficulties for regulation). The focus on regulation of price rather than say investment, research and development, may also reflect the essentially static nature of neoclassical economics.

The agency theory and transactions costs economics approaches could then explain the occurrence of privatisation through some combination of changes in perceptions of the principal-agent issues and changes in the structure of transactions costs. This would though leave unexplained how and why the perceptions of the role of property rights and of principal-agent issues changed. It is rather debatable as to whether the principal-agent issue and transactions costs have had much effect on the nature and forms of privatisation. Some utilities have been privatised in a vertically disintegrated form (the British railway system is a well-known example) and the ways in which principal-agent matters arise and the transactions costs (in a broad sense) arise in a disintegrated industry do not appear to have had much impact on the way in which privatisation has been structured.

5.4 Efficiency

Private ownership versus public ownership is often discussed in terms of the relative efficiency of the different forms of ownership. The Austrian approach most clearly postulates that private ownership will be more efficient than public ownership and in effect judges efficiency in terms of profitability. Survival in the market becomes the test of efficiency. The neoclassical approach has clear notions of efficiency in terms of allocative

and technical efficiency, where the latter refers to the degree to which the output of a productive process is the maximum which is technically possible given the inputs, and the former to whether the right balance of inputs is chosen and whether there is the optimal allocation of resources between different activities. It is relevant to note the shortcomings of such an approach to efficiency. First, it is well known that the efficiency criteria of neoclassical welfare economics pay no attention to issues of distribution. Privatisation may well lead to a different structure of prices (as compared with public ownership) which has a differential impact on income groups. It is often seen that the pricing structure post-privatisation favours the rich rather than the poor. Second, little attention is paid to wages and conditions of labour. If cost efficiency is increased through the payment of lower wages and/or the intensification of labour, it would be doubted as to whether that can be considered as improving social welfare. Third, the neoclassical approach adopts a rather static approach and does not pay sufficient attention to issues of investment and technical progress. The impact which privatisation has on the extent of investment particularly in the public utilities has been little considered but it is of considerable importance for the secure supply of essentials such as water and electricity. Fourth, the nature and 'quality' of the product is liable to change under privatisation and liberalisation. Regulation of privatised utilities has focused on price and has found difficulty in ensuring quality. Liberalisation in the form of 'contracting out' of public services has faced problems of writing and monitoring the contracts in a way to ensure good quality services are provided.

This brief discussion points to the conclusion that privatisation cannot be adequately assessed using the narrow concept of efficiency associated with neoclassical economics. Social welfare cannot be narrowly aligned with costs of production or profitability. A broader range of considerations, some of which have been indicated above, have to be brought into the picture.

5.5 The political economy of privatisation

The big push towards privatisation can be dated as starting in the early 1980s, and gathering pace from the late 1980s, though there were some previous examples of privatisation in market economies alongside some extensions of public ownership. This push towards privatisation has clearly gone on alongside the rise and dominance of neoliberalism at the national and international levels. Privatisation epitomises neoliberalism in terms of the further expansion of markets and competition in economic life, the entry of capital into new areas and the greater importance of the financial sector and of profits and the pursuit of profits at the expense of all other considerations.

In Western European countries private ownership has been the norm,and this leads to looking for reasons, rationales and pressures for public ownership as exceptions to that norm. In some cases, the extension of public ownership was seen by those advocating it as a step on the road to a socialist economy. But in others, especially when undertaken by right of centre governments, as an unfortunate necessity in order to rescue a failing firm.

Public ownership has also quite often arisen in response to failures of private companies and the threat of bankruptcy for companies that are deemed 'too important to fail'. Inefficiency and bankruptcy per se clearly do not lead to public ownership – after all many companies are inefficient and some go bankrupt. It is often combined with the strategic importance of the firm concerned and the employment and other consequences of its demise. In other cases, nationalization was undertaken to facilitate greater industrial efficiency (for example through exploitation of economies of scale), rationalization (often in the face of industrial decline) and modernisation. Public ownership was also used to foster economic development (for example IRI in Italy).

5.5.1 Opportunities for profits and accumulation

Privatisation shifts assets and productive processes undertaken by the state into the hands of private companies. The assets are often sold at a price which does not reflect their profit potential. Clearly privatisation involves enhanced prospects for profits and accumulation within the private sector. Privatisation offered new markets for private capital accumulation at a time when there was insufficient aggregate demand and profits had been squeezed. This was especially the case in European countries after the 1970s when restrictive macroeconomic policies became predominant. Profitability was restored by the end of the second half of the 1980s, but without durable recovery of the rate of accumulation at the macroeconomic level due to the insufficiency of demand, but also, presumably, to the impact of the financial liberalisation which favoured more financial accumulation. In this environment large and secure markets, mainly in public utilities and pensions systems, and to a less extent in the health system, were made accessible for private capital accumulation thanks to the privatisation process. Profitable activities were easily privatised while activities with deficits remained in the public sector.

Privatisation in the form of the contracting out of public services to private contractors, and the gradual incursion of private companies into the provision of public services which had traditionally been provided by public employees are clearly to be seen as part of the extension of the market economy. This not only accorded with ideas that all economic activities should be undertaken through the market, but also enabled activities which had previously been removed from the pursuit of profits now coming into the orbit of profits and private accumulation.

5.5.2 Role of the financial sector

The interests of the financial sector in the promotion of privatisation are perhaps self-evident. There are substantial fees, commissions and income generated by the processes of privatisation. The underwriting fees of the share issues, the income from dealing in the shares in the privatised companies and so on, come immediately to mind. Public private partnerships are also lucrative for the financial sector when that is taken to also include accountancy firms and economic consultants. Deals have to be arranged, finance provided, consultancy advice provided at a price and so on, and both private companies and the public sector draw on the consultancy firms for advice with regard to public private partnerships and the involvement of the private sector in provision of public services. "Some financial institution can make enormous amounts of money by arranging the sale of assets including their commissions. Their political advisors also benefit, specifically in terms of their salary as directors of previously publicly owned companies" (Tatahi, 2006, pp. 5–6).

In varying ways, one of the objectives of privatisation reflected in the way in which the privatisation was undertaken has often been the development of equity markets and the spread of share ownership. Privatisation has also been promoted on the grounds of developing the stock exchange (for example in terms of breadth and liquidity) especially in the context of emerging markets. This argument in turn has rested on the view that financial development (particularly with regard to the stock market) is a stimulus to economic growth.

The financialisation, "the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies" (Epstein, 2005, p. 3) is a widely observed phenomenon. Privatisation is clearly making a significant contribution to that process of financialisation. But a much more significant element comes from the increased role of financial motives and financial institutions in the operation of large public utilities. Further, privatisation serves to inject financial motives into the provision of a range of public services.

The sale of shares in the privatised utilities were also undertaken at a significant discount with small individual shareholders as the target group. These policies not only indicate the intentions of these privatisation in terms of changing ownership patterns, but also that the financial benefits of privatisation are concentrated on a relatively small number. In contrast, the financial and others costs are spread and diffuse. The financial benefits of privatisation of utilities arose for those who were able to purchase shares, whereas the losses were spread over the whole community.

5.5.3 Privatisation and the public finances

The pressures on government finance with a perceived need to reduce budget deficits have frequently been mentioned as significant in the drive towards privatisation. The budget deficit, that is the balance between revenue and

expenditure, has (nearly) always been the centre of attention in debates over public finances. It is rarely the case that attention is given to the government's balance sheet in terms of assets and liabilities, and where it is a concern over liabilities and not assets. The sale of public assets is generally recorded as negative expenditure, which not only reduces the budget deficit but also appears to reduce the scale (for that year) of public expenditure. However, if the sale of public assets were treated as a transaction on the capital account, it becomes another way of financing a budget deficit. In effect the sale of public assets goes alongside sale of bonds as a means of deficit funding. As bonds have a cost in terms of future interest payments so the sale of public assets has a cost in terms of the financial and other benefits from the public operation of those assets. If it were the case that the private sector was unwilling or unable to fund a budget deficit, then the use of an 'accounting trick' is unlikely to make much difference. The funding requirements placed on the private sector are the same, though the financial instruments used are different.

Public assets can for this purpose be conveniently divided into two. There are firstly those assets which help to provide public goods and services but which do not directly generate a financial flow (for example profits). Secondly, there are assets (typically operated by public corporations) which help to produce goods and services which are sold to the public and on which profits could be said to be earned.

Privatisation with regard to the first type of asset has essentially involved a leasing back arrangement whereby the asset is owned and operated by the private sector in exchange for a leasing and service fee. The private finance initiative (PFI) and public private partnerships fall in this category. The immediate impact of the use of a PFI (as compared with a conventional finance capital project by government) is to reduce government borrowing requirement. However, the longer term effect on budget deficit is likely to be negative: the future stream of leasing payments under PFI will in general exceed the stream of interest payments (which would arise under conventional finance).

A similar argument applies in the case of state-owned enterprises. In public ownership, those enterprises would yield a future stream of profits which are now lost to the public sector following privatisation. It could be argued that state-owned enterprises are often loss-making, but if so that makes them an unattractive proposition for private investors.

The loss to the public sector is amplified by the general underpricing of privatised companies. There does not seem any doubt that there has been underpricing in general, though the question can be asked as to how the degree of underpricing compares with that which occurs with share floatation of private companies.

5.5.4 Privatisation and globalisation

Public ownership generally involves ownership by the nation state, but not at the supra-national level. Ownership at regional or local government

level can also be involved and some similar arguments to those developed here would apply at that level. Public ownership has been undertaken for a variety of reasons and has often involved control over and development of production within the country concerned. Publicly owned utilities could often have sole rights to produce the product concerned. The linkages between privatisation and globalisation may then be self-evident. In one direction, public ownership may place limits on the enterprise concerned from expansion outside its national market and to enable entry into strategic alliances with foreign partners (see Andre, 2006, p. 7). "[I]t has been argued that private companies have more direct and faster access to the international capital market than public companies do" (Tatahi, 2006, p. 3). In the other direction, entry of foreign companies into the domestic market would be eased through privatisation. As indicated above, some proponents of privatisation linked liberalisation with privatisation, and specifically removal of entry barriers, and the removal of those barriers permits foreign entry into the domestic market. Although privatisation sometimes involved the retention of some 'golden share' by the government, in general there were few limitations over the eventual ownership of shares in the privatised companies. "The sizable penetration of foreign capital into British companies occurred as a result of a combination of circumstances, not all of them attributable to privatization. The macroeconomic and monetary conditions surrounding privatization certainly played an important role, but divestitures offered welcome opportunities to international investors" (Florio, 2004, p. 144). Florio (2004) Chapter 5 provides an indication for British privatisations of the extent to which shares in privatised companies were acquired by foreign owners and the acquisitions of privatised firms by foreign companies.

Privatisation is then related with globalisation both in terms of shifts from in effect guaranteed national ownership of a range of production facilities to facilities for foreign ownership, and facilitating the expansion of multinational operations by enterprises.

5.5.5 Privatisation and labour market flexibility

The search for more flexibility of the wage relation was regarded as a key issue since the 1980s as it was supposed to help to reduce costs and improve profitability. In most cases trade unions were in relatively strong positions in the public sector as compared with much of the private sector. Consequently privatisation weakened trade unions' positions and helped indirectly to promote more flexible wage relations. More generally it changed the rules in the privatised sectors and introduced more competition, notably in the wage relation. The reduction of trade union power was a major theme of the Thatcher government in the UK in the 1980s, with many changes in industrial relations law designed to diminish the role of the trade unions. This went along side the major privatisation programme, and indeed the use of

privatisation to constrain trade union power is frequently mentioned as a major motive for privatisation in the UK during the 1980s. Tatahi concludes that "the implementation of the privatisation process involves reorganisation and restructuring of the balance between these two parties. As a result, the balance has shifted between these two parties.... Privatisation and its effects cannot be ignored in enhancing the flexibility of the labour market, shifting the balance in favour of capital and resulting in significantly weakening labour" (Tatahi, 2006, p. 7).

5.5.6 'Technical matters'

The criteria used to justify public intervention and ownership have changed under the effect of technical evolutions. Some activities, like telecommunications, formerly with increasing returns, have turned into activities with decreasing returns thanks to technical innovations, thus rendering the monopolistic situation obsolete. The segmentation of activities, like in railways or electricity, has been developed and allowed the division of companies into several segments which could partly be submitted to competition. Consequently, traditional criteria (increasing returns, externalities) tended to disappear in favour of the nature of the information which could be easily manipulated or not. Conversely, the difficulties involved in the contracting out of an activity arising from asymmetric information, costs of writing and monitoring contracts justified maintaining a public operator. It is argued that

> a major factor behind privatisation is to be found in developments associated with new technology. These have had the effect of breaking down the traditional boundaries that divide one sector of the economy from another. New technology has been generally applicable, adaptable and cheap, with potential use in production, management and marketing. Accordingly, the economy is going through a particularly intense period of reorganisation along the lines of vertical and horizontal integration, especially where new technology is concerned (Fine, 1990, p. 139).

5.6 Concluding comments

In this chapter we have sought to lay out a range of ideas coming from economic and political economy analysis which have fed into policies on privatisation and liberalisation and which have also informed the debates over the effects of privatisation.

Notes

1. The Austrian approach dates back to the late nineteenth century, taking its name from the nationality of a number of its founders including Carl Menger, Eugen

von Böhm-Bawerk and Friedrich Hayek. A key feature of its approach is adherence to methodological individualism – analyzing human action from the perspective of individual agents. See Littlechild (1990) for a collection of major papers on Austrian economics and Littlechild (1986) for application of ideas to the mixed economy.

2. Neoclassical economic analysis is the dominant school in economics though it is difficult to define with precision. It is often seen to involve a methodological individualism approach and revolve around utility and profit maximisation and the interaction of demand and supply. For readings see Ricketts (1989).

References

Andre, C. (2006) *Privatizations in France*, www.presom.eu.

Beesley, M. and Littlechild, S. C. (1983) "Privatization: Principles, Problems and Priorities", *Lloyds Bank Review*, July (reprinted in M. E. Beesley, *Privatization, Regulation and Deregulation*, London: Routledge, second edition, 1997).

Epstein, G. (2005) "Introduction: Financialization and the World Economy" in Gerald Epstein and Edward Elgar (eds) *Financialization and the World Economy* (Cheltenham, UK; Northampton, MA).

Fine, B. (1990) "Scaling the Commanding Heights of Public Enterprise Economics", *Cambridge Journal of Economics,* Vol. 14, pp. 127–142.

Florio, M. (2004) *The Great Divestiture: Evaluating the Welfare Impact of the British Privatizations, 1979–1997* (Cambridge, MA; London: MIT).

Friedman, M. (1962) *Capitalism and Freedom* (Chicago, IL: University of Chicago Press).

Leibenstein, H. (1966) "Allocative Efficiency vs. 'X-Inefficiency' ", *American Economic Review*, Vol. 56, No. 3, pp. 392–415.

Lipsey, R. and Lancaster, K. (1956) "The General Theory of Second Best", *The Review of Economic Studies*, Vol. 24, No. 1, pp. 11–32.

Littlechild, S. (1986) *The Fallacy of the Mixed Economy: An 'Austrian' Critique of Recent Economic Thinking and Policy* (London: Institute of Economic Affairs).

Littlechild, S. (ed.) (1990) *Austrian Economics vol. 1 to 3* (Aldershot: Elgar).

Littlechild, S. C. (2000) *Privatisation, Competition and Regulation* (Institute of Economic Affairs Occasional Paper 110).

Ricketts, M. (1989) *Neo-Classical Microeconomics* (Aldershot: Edward Elgar).

Tatahi, M. (2006) Privatisation Performance in Major European Countries since 1980 (Basingstoke: Palgrave/Macmillan).

6
The European Social Models: Contours of the Discussion

Christoph Hermann

6.1 Introduction

The term European Social Model (ESM) has become a catchword in political, and increasingly academic, discourses. This chapter attempts to map out the contours of the discussion on the ESM. It does so by devoting the first part of the chapter to the changing political meaning of the ESM with a special focus on its role in the European integration process and the maintenance of a hegemonic European project. In contrast, the second part refers to academic discourses on the ESM. More concretely, it engages with quantitative approaches attempting to measure the ESM, and institutional concepts searching for a common institutional tradition shared by the great variety of EU member states. The chapter argues that widespread public ownership is a common feature shared by many countries in Western and Eastern Europe during the post-war decades and distinguishing Europe from the social model of the United States. The chapter ends with a brief conclusion.

6.2 The politics of the ESM

The invention of the term 'European Social Model' is commonly attributed to the former president of the European Commission, Jacques Delors. Delors was a supporter of a social democratic vision of a unified Europe in a globalised world. As finance minister he had first-hand experiences with the failure of President Francois Mitterrand's recourse to Keynesianism in France in the early 1980s. The social democratic lesson was that after the fall of the Bretton Woods agreement, the subsequent abolition of capital controls and the internationalisation of money markets, the national level was no longer viable to establish a progressive economic policy. Instead, social democratic forces, not only in France but also in other European countries, increasingly focused on the European level in order to build an alternative to the free-market style capitalism that dominated Britain and the United States. This does not mean that Delors and fellow social democrats were

not in favour of the Single Market and the Economic and Monetary Union. However, they felt that Europe had to be more than simply an economic association. As Delors once famously stated, "you cannot fall in love with a common market." As part of the social democratic vision, the ESM was also directed against Britain and the United States, which in the 1980s were both ruled by straightforward neoconservative governments. The basic idea was that economic and social progress should be equally important objectives and an economically successful union should have an explicit social policy agenda and strong European-wide social and labour standards. Europe, in short, should take the 'high road' to economic growth and prosperity (Hofbauer, 2007, p. 40).

Yet although the 1992 Treaty of Maastricht for the first time included a social protocol allowing for majority decisions in social policy issues and enabling the social partners to negotiate agreements which would then be translated into binding EU legislation, the social dimension remained marginal and the social democratic strategy failed. Instead, those forces that not only demanded a common market in Europe but also unrestricted trade and capital movement between Europe and the rest of the world prevailed. In this process the institutional framework that gave free trade proponents such as Britain, Germany and the Netherlands effective veto rights proved of decisive importance. But also, the specific nature of the market characterised by mutual recognition rather than supranational harmonisation played an important role (Hermann, 2007, pp. 71–72). Such a market could hardly be combined with the social democratic demand for strong Europe-wide standards.

However, while the neoliberal forces succeeded in the struggle for the future direction of the integration process, the integration process itself became increasingly questioned precisely because of its neoliberal bias and the problems created by its emphasis on monetary restraint and budgetary austerity. Among these problems were low economic growth rates and increasing unemployment. Against the background of rising disillusion and frustration, also known as post-Maastricht crisis, the ruling political and economic elites in Europe risked losing support for the Economic and Monetary Union (Deppe and Felder, 1993). In this situation, frequent references to the ESM must be seen as part of a strategy to maintain support for a predominately neoliberal integration project.

6.2.1 Legitimating neo-liberalism

The European integration project is a hegemonic project (Jessop, 2004, p. 2). As such it requires a hegemonic bloc that delivers sufficient support to keep the integration process going. On several occasions the process came to a halt and was threatened with reversal. The rejection of the Maastricht Treaty in Denmark or more recently the rejection of the European constitution in France and Netherlands and of the Lisbon Treaty in Ireland are such points. A hegemonic bloc is built on class and social compromises and is able

to integrate critical views and forces. Most importantly, it must give these potentially opposing forces a perspective, a vision they can identify with. As Andreas Bieler (2007) has shown, many of the trade union organisations that supported the European integration process did not do so unanimously and unconditionally. They were aware and critical of the negative consequences of the Maastricht criteria and the Growth and Stability Pact, but they nevertheless continued to support it. Bieler (ibid., p. 7) argues that the unions were simply not strong enough to oppose these developments, not least because of the economic crisis and rising unemployment. However, the fact that European politicians and bureaucrats frequently made reference to the ESM, which the unions still associated with social progress and high labour standards, also made sure that trade union representatives would have a reason to believe that the current state was only transitional, and even more importantly, have an argument against internal opposition. References to the ESM were also important to pacify the left-wing opposition within the social democratic parties.

In 1994, the European Commission published a White Paper on Social Policy. Therein the Commission defined the ESM as "a number of shared values" including "democracy and individual rights, free collective bargaining, the market economy, equality of opportunity for all and social welfare and solidarity." (European Commission, 1994, p. 2). This stood in stark contrast to the cuts in social benefits that were triggered by the austerity policies imposed by the Maastricht deficit limits, and which were certainly not designed to boost solidarity.

However, the restructuring of the social security systems not only increased inequality; budget cuts and high interest rates also continued to restrict economic expansion and fuel unemployment across Europe. As a result, France experienced massive demonstrations in 1995, followed by the election of a left-wing government in 1997. The protests in France were followed by demonstrations in other EU member states in the second half of the 1990s, when hundreds of thousands of citizens were taking part in a series of European marches against unemployment. Unemployment had already dominated the Council of Essen in 1994 and it continued to trouble the national leaders at the Council of Amsterdam in 1997. As a response to the looming employment crisis, the Council adopted the European Employment Strategy. The Employment Strategy did not only aim at creating new employment; it also promoted social justice issues such as equal opportunities and non-discrimination in workplaces. Such issues were also perceived as important elements of the ESM. However, with the adoption of the Employment Strategy the access to employment has not only become a crucial feature of the ESM but also a benchmark for its success.

6.2.2 Neo-liberal modernisation

European policymakers continued to legitimise a predominantly neoliberal integration process by repeated references to the ESM. The draft constitution

for the European Union rejected by French and Dutch voters in spring 2005 included a paragraph on the ESM, while giving monetary restraint and budgetary austerity a constitutional status. The commitment to a solidaristic and socially just Europe, even if it was hardly more than lip-service together with some improvements for the role of the European Parliament, convinced even left-wing representatives in social democratic and green parties to vote for the constitution.

However, with the adoption of the Lisbon Agenda in 2000, the discourse on the ESM experienced another decisive twist. References to the ESM were not only used for legitimisation; instead the ESM was increasingly deployed as an argument to demand a radical restructuring and restriction of the existing European welfare systems. The general argument goes as follows: The European Union and its members states are confronted with a number of common challenges and responsibilities, including globalisation and ageing societies. Globalisation forces Europe to be more competitive in an increasingly internationalised world. Accordingly, competitiveness is a precondition to be successful and to be able to retain high labour and social standards. Therefore, the ESM must be subordinated to the overall objective of competitiveness. Or even better, the ESM must be used as source to improve Europe's potential to succeed on the world markets; the ESM becomes a productive factor. As stated in the 2004 Social Policy Agenda, "[t]he objectives of employment, solidarity and social inclusion cannot be separated from the globalized economy, where the competitiveness and attractiveness of Europe are at stake" (European Commission, 2005a, p. 4). With respect to ageing societies, the argument is that existing social security systems must be reformed in order to guarantee future generations the same level of protection enjoyed by the existing population. As the director of the Lisbon Council, Ann Mettler (2005, p. 27), argues, "[m]odernising the European Social Model is first and foremost about sustainability and generational justice.... Without reform, pension and social security systems will simply collapse. Without reform, we are consuming the fiscal resources of our children and grandchildren." Martin Beckmann et al. (2006) call this process of change a transformation from a 'regime of stabilisation' to a 'regime of modernisation'. While the first was mainly based on and supportive of national social regulation, the second is based more on promoting the transformation of the national social models under the guideline of neoliberal flexibilisation and deregulation.

Apart from the privatisation of pension systems, much of the reform agenda actually centers on labour markets and employment issues. The flexibilisation of labour markets is seen as essential for improving overall competitiveness and saving social security systems. An influential contribution in this regard was made by the Belgium economist André Sapir (2006). His paper on 'Globalisation and the Reform of the European Social Models' was distributed by the British presidency as background paper at the 2005 Ecofin meeting in Manchester. Therein Sapir argues that generally there is

a trade-off between high levels of equality and high levels of employment. The only model that actually manages to combine both goals is the Nordic Model. The Anglo-Saxon Model is also sustainable because it puts greater emphasis on employment. The Continental and Mediterranean Models may deliver high levels of equality, but they are not sustainable because of their poor employment performances. Sapir's conclusion is that the latter two, which account for about two thirds of Europe's Gross Domestic Product (GDP) and 90 per cent of that of the Eurozone, must "be reformed in the direction of greater efficiency by reducing disincentives to work and to grow" (ibid., p. 381).

Hence, although equal opportunities and anti-discrimination play an important role in the modernisation discourse, the actual policies proposed under the modernisation label are largely employment centred. Not only this, but they are also exclusively supply sided, including measures such as lifelong learning, labour flexibility, the promotion of employability and entrepreneurship, as well as the introduction of incentives to work more and longer. "The bottom line is that we will only meet the new challenge if people have a new attitude to work and our social systems have a new attitude towards people" (European Commission, 2005b). Social policy is reduced to employment policy and the success of the ESM is measured in sufficiently high employment rates – a measurement according to which Europe is notoriously lacking behind the United States. Social justice issues are still mentioned in official documents and speeches, but they play only a subordinated role if any at all. As Jane Lewis (2007, p. 54ff) has noted, following the employment paradigm the issue of equal opportunities is reduced to the question of female employment rates, whereas the unequal distribution of paid and unpaid work and other forms of discrimination are no longer at stake. In a similar way, gender mainstreaming has been reduced to a method for eliminating barriers to female employment careers.

In short, while making references to the ESM, the political and economic elites in Europe are threatening the very foundation of the European welfare systems. "Social policy", as Birgit Mahnkopf (2007, p. 98) writes,

> no longer aims at a correction of the primary distribution through the market, and is also not intended as a publicly guaranteed legal right to a form of living independent of the market. The concept of the welfare state is thereby turning almost into its opposite. The requirement of 'modern' welfare statism is no longer the targeted, socially effective redistribution in favour of weaker population groups and regions, but the promotion of entrepreneurial action and the protection of business property – because this, it is said, stimulates the individual's readiness to work.

Instead of protecting people from the market, social policy is increasingly seen as an instrument to help them to adjust to the market (Jepsen, and Amparo, 2005, p. 238). In the words of the European Commission: "In the

past, social policy has enabled the European Union to manage structural change.... In the future, modernising the European social model and investing in people will be crucial to retain the European social values of solidarity and justice while improving economic performance" (European Commission, 2000, p. 6).

6.2.3 An alternative to neo-liberal capitalism?

As mentioned above the ESM was invented by Delors to distinguish Europe from the United States. It is this distinction which to a large extent is responsible for the appeal of the term European Social Model and its continuous popularity in large parts of the population. Paradoxically, the European elites are playing with these resentments to put forward a modernisation agenda that erodes rather than strengthens the distinctive qualities of the ESM. But this cannot hide the fact that the ESM is also a critique of neo-liberalism, which is believed to have its ideological roots, and its strongest political and institutional support in the United States.[1] "The European Social Model", as Jörg Huffschmid and colleagues (2005, p. 182) write, "should not be regarded only as an instrument to enhance economic strength and competitiveness in the world. Indeed it is the other way round: the European Social Model is the objective and end of economic and social policy, and to reach this objective a certain strength and competitiveness are required". And as Michael Krätke (2005, p. 92) argues, despite decades of neoliberal restructuring the concept of the welfare state, which is not just obliged to the owners of capital but to all citizens, still enjoys the widest support in most European countries. "The neoliberal idea of the minimal state, which goes back to pure relief of poverty, is a long way from having won, even if the market ideologies that are part of it dominate the minds of the so-called elite." Krätke therefore suggests that the European left could use the ESM as a trademark for a new political project (ibid.). Groups such as Attac and social forum activists, but also left-wing parties and trade unions, have taken up this idea and used the notion of the ESM to put forward their agenda for an alternative and sustainable Europe based on solidarity rather than market fundamentalism (see Chapter 17).

6.3 Conceptualising the ESM

Analytically the term European Social Model only makes sense in contrast to other social models. In academic discourses on the ESM the main point of reference has been the United States, although the lack of comparisons with other developed countries, let alone developing countries, is simultaneously one of the major weaknesses of the debate.[2] The debates centre around two major approaches: a quantitative approach that attempts to measure the differences between Europe and the United Sates, and an institutional approach that is looking for common although distinctive institutional settings in European societies.

6.3.1 Measuring the ESM?

One part of the literature on the ESM attempts to measure differences between Europe and the United States. Comparisons typically centre around four issues: material wealth (production and consumption), unemployment, inequality and poverty. Measured in terms of GDP per capita (in purchasing power standards and at current prices) United States values were 35 per cent higher than the EU-27 and 27 per cent higher than the EU-15 in 2006 (European Commission, 2007, p. 20). Higher GDP per capita is partly the result of higher productivity growth, but more importantly are the longer working hours put in by American workers. According to OECD data, in 2006 Americans in employment on average worked more than 300 hours longer per year than their counterparts in Germany, the Netherlands or France (that is almost two months calculated on a 40-hour week). The question of course is if material wealth automatically means more well-being and countries with high levels of private (mass) consumption are necessarily richer than those with a higher proportion of collective consumption and more free time.

On the other hand, Europe has a high proportion of involuntary free time in the form of workers who cannot find work. Before the crisis that began in 2007, the average unemployment rate in the EU fell to 7.9 per cent in 2006 whereas the proportion of the population in employment rose to 64.3 per cent in the same year (European Commission, 2007, p. 20). Yet despite some improvements in recent years, "the average EU employment rate remains well below that of the United States and Japan, while the average EU unemployment rate is still almost double the rate in the United States and Japan" (ibid.). However, there are EU member states with lower unemployment rates than the United States, including most notably Denmark and Sweden (ibid.).

While Americans have higher GDP per capita, work longer hours and are less frequently unemployed, Europe has a smaller proportion of poor citizens and wealth is distributed more equally among its population. In the United States, 17.1 per cent of the population earned less than half of the national mean income in 2005, while in 19 EU member states for which the OECD provides data the proportion is 9.3 per cent. Compared with Denmark and Sweden the American relative poverty rate was three times higher. But in Southern Europe and Ireland the poverty rate was closer to the US level than to Northern Europe. The comparison of income inequality shows a similar picture: The Gini index, a common measurement of inequality, is one and a half times greater in the United States than in Sweden and Denmark and substantially greater than in Northern and Continental Europe (European Commission, 2008, p. 35). Roughly the same relationship is revealed if we compare the income acquired by those at the top 10th percentile of the income scale to that of the bottom 90th percentile of the income scale. According to these measurements, only two EU member states show a higher degree of inequality than the United States – Portugal and Lithuania (ibid., pp. 35–36). However, inequality measured across the EU is only slightly lower than inequality in the United States (ibid.). The highest

values for inequality measurement within Europe can be found in Portugal, Lithuania and Latvia, the lowest in Sweden, Demark and Finland (ibid.).

Higher income equality in Europe is mirrored by a higher percentage of government expenditure on social benefits and transfers (Alesina and Glaeser, 2004, p. 17). While in the United States social expenditure accounted for 15.9 per cent of GDP in 2005, in 18 EU member states for which the OECD provides data the average amounted to 23.5 per cent. In Sweden and France the proportion of social expenditure was almost twice as high as in the United States. Again, differences within Europe are even more pronounced than the difference between the European average and the US rate. The percentage of social expenditure as percentage of GDP ranges from 29.7 per cent in Sweden to 16.7 per cent in Ireland and Slovakia.

There are two fundamental problems with statistical comparisons between the United States and Europe. First, differences between EU member states are often greater than the difference between the European mean and the United States (Alber, 2006, p. 412). Differences are particularly apparent if we compare Northern and Southern Europe, Anglo-Saxon and Continental European countries as well as 'old' Europe and the new member states. Second, inequality and relative poverty with few exceptions has actually increased in Europe over the last two decades indicating a gradual decline of Europe's difference with the US since the 1980s. Of course this development not accidentally coincidences with the rise of neo-liberalism on both sides of the Atlantic. In a comparison of the Gini coefficient in the 1980s and in the year 2000 Alber shows that in eight out of twelve EU member states (for which data were available) inequality increased and in five countries it increased even faster than in the United States (ibid., p. 408). Similarly, 10 out of 13 EU member states recorded an increase in relative poverty between 1986 and 2000 (ibid.). Alber concludes that "Europe has... moved into the direction of the United States in terms of income inequality, even though the degree of inequality is still much higher and grew even more in America" (ibid., p. 405).

6.3.2 In search for common institutions

There is a body of literature that analyses welfare institutions and their development over time. On aggregate, these institutions form what after the Second World War became known as welfare states. Europe is far from having a common welfare state. Instead, European countries are typically grouped according to different welfare state models. Gøsta Esping-Andersen (1990) initially differentiates between 'Three Worlds of Welfare Capitalism' – including the liberal (United Kingdom), conservative (continental Europe) and social democratic types of welfare states (the Nordic countries). Others have added additional categories to account for the peculiarities of the southern European welfare states (Ferrera, 1996) and more recently for the specific situation of the transition economies in Central and Eastern

Europe, while feminists have reinterpreted and modified these models according to different household arrangements (Lewis, 1992). In this context, the focus has been broadened from social protection to include other aspects of welfare policies such as tax and family policies and other actors than the state causing some authors to use the term welfare regimes rather than welfare states (André, 2006). Again, other comparisons ultimately distinguish between Anglo-Saxon, Nordic, Continental and Mediterranean welfare models (Sapir, 2006).

There are important differences between these models including the mode of funding and of provision, access to benefits, the degree of coverage, level of assistance, as well as discrimination and exclusion of certain groups of people (e.g., residents with foreign citizenship). Yet at least the Western European welfare states also have strong similarities. Martin Kronauer (2007, pp. 64–65) emphasises three common characteristics: First, in contrast to the state-socialist systems in Eastern Europe, Western European welfare states did not question the legitimacy of private ownership of the means of production (although they imposed rules on companies for the protection of workers). However, with the expansion of the public sector and the control of the production of public goods in the post-war decades, Western European welfare states gained substantial capacity to directly intervene in economic issues that go beyond fiscal and monetary policies. Second, in contrast to the social model of the United States but also to most Southern European countries, Western European welfare states were universalistic. "They officially recognize a responsibility not just for particular groups in need but for all citizens with regard to their basic well-being in the most important dimensions of everyday life" (ibid.). Universalism should not be confused with egalitarianism. In fact, the minimum provided by Western European welfare states can differ considerably, as can easily be seen if Germany is compared to Sweden. However, the universalistic tradition is clearly "not compatible with the exclusion of large parts of the population from health insurance or a welfare reform which threatens unemployed poor people with the loss of any income support for life time after five years" (ibid.).[3] Third, Western European welfare universalism is linked to a concept of social rights that exists in addition to political rights granted to all citizens in modern Western democracies (ibid.). James Wickham (2005, p. 7) makes a similar argument when stating that "citizenship in Europe includes *social* citizenship, that is, that cluster of rights to education, health and social security" (Italics in original).

Another string of comparative literature deals with social models or models of capitalism. Representatives of the varieties of capitalism literature have differentiated between Anglo-Saxon and Rhineland capitalism (Albert, 1993), liberal market and coordinated market economies (Hall and Soskice, 2001), or between market-led, negotiated and state-led capitalisms (Coates, 2000). Anglo-Saxon, liberal market or market-led capitalisms stand out in

these comparisons as here the market and competition plays a more important role in governing economic activities than in the other systems. While these comparisons (in contrast to the welfare state typologies) were not developed to compare European countries – in fact much of the literature centres on the comparison between the United States, Germany and Japan – they nevertheless show that in terms of population numbers the vast majority of Europeans live in coordinated or state-led forms of capitalism. According to another terminology, Continental and Northern European countries have therefore been described as social-market economies (Pontusson, 2005) and even the European Commission (2005a, p. 4) has recently acknowledged the "European choice in favour of a social-market economy."

Coordinated or social-market economies distinguish themselves from their liberal-market counterparts not least by having strongly regulated employment models and developed industrial relations systems (Pontusson, 2005, 25ff; Bosch, Lehndorff and Rubery, 2009). Hence as Richard Hyman points out (2005, p. 11) there are "significant common features in continental Western Europe which distinguish it from both the 'American model' of largely deregulated labour markets and the 'Japanese model' of management-dominated company employment relations." Hyman highlights three important characteristics: there are substantial statutory limits on the way labour (power) can be bought and sold (e.g., employment protection); collective agreements usually have priority over individual employment contracts; there is a broad consensus that workers have independent interests and it follows from the acknowledgement of independent interest representation that there should be some form of interest coordination (e.g., social partnership).

A vital difference between Europe and the United States, although often overseen in institutionalist literature, is the extent and role of public ownership. True, public ownership is not completely alien to the US model, but public ownership remained limited to a few and mostly local services or services of special importance for national security (the notable exception is the publicly owned US Postal Service). While in Eastern Europe virtually all large companies were state owned in the former communist systems, in Western Europe many governments nationalised key industries, banks and public services in the post-war years (see Part 2 of this book). US governments, in contrast, were more inclined to contract private providers to supply public services. An outstanding example is the largely private American health industry with private health insurance companies as major actors. If we focus on the extent of public ownership, including the national health system, there is no doubt that the United Kingdom belonged to Europe in the post-war decades rather than to a liberal Anglo-Saxon model, and there were even strong commonalities between the otherwise very different Western and Eastern Europe countries.

This does not mean that the United States has not accounted for the essential importance of public services and disregarded the specific nature of public service markets. As Greg Palast, Jerrold Oppenheim and Theo MacGregor (2003) have pointed out, the United States in part developed rather complex and comprehensive regulatory systems to oversee the privately owned network industries. Hence, while Europe frequently relied on public ownership to make sure that public service providers meet the needs of citizens and businesses, the United States focused on regulation. However, despite comprehensive regulation it was widely accepted that the provision of public services in the United States must yield a profit for the private owners, whereas in Europe fees only covered costs (more often public service providers even had losses) or in case of profits these belonged to the public. In connection with public welfare and public ownership, the state more generally played a much stronger and penetrating role in European societies than in the United States. The state was not primarily seen as a danger to individual freedom – although in the authoritarian communist systems in Eastern Europe citizens have often experienced the state apparatus as a threat – but as a benign force that guarantees social coherence and enables economic growth (Mahnkopf, 2007). The positive attitude towards state support and intervention is perhaps best expressed in the French notion of the *service public* which underlines the special responsibility of public institutions and its representatives.

6.3.3 The essence of the ESM

In essence, far from being a well-developed analytical concept the ESM before the recent waves of neoliberal restructuring can nevertheless be characterised by three main features: First, a universalistic character of welfare provision which guarantees its citizens a minimum level of social existence (residents without citizenship were often excluded). Second, a high degree of coordination between economic actors and the acknowledgement of the need for special provisions to protect workers and their labour power. Third, widespread public ownership in key industries and banks and, most notably, in the provision of public services. This means that European citizens on average were less exposed to market forces or in their social existence less integrated in the cycle of capitalist accumulation than citizens in other developed capitalist countries including the United States. This is not only true for citizens in Eastern Europe who lived in state-planned economies but also in Western Europe with its social-market capitalism. Since its citizens were less dependent on market forces, European societies in sum displayed a higher degree of decommodification. In quantitative terms this can be seen in a comparatively high degree of equality. In contrast, recent cuts in welfare systems, the continuous weakening of collective bargaining and trade union representation and, above all, the privatisation of public services amounted

to a significant recommodification of social life in Europe. The commodification, in turn, threatens to erode the very foundations of the ESM. Not surprisingly, a major effect of the changes as described in more detail in the second part of the book has been mounting inequality. Interestingly, as described in the first part of this chapter, the political elites in Europe use the term ESM to defend these changes.

6.4 Conclusion

Although the ESM is far from being a well-developed analytical concept, in essence it is characterised by three main features: The universalistic character of welfare provision, a high degree of coordination between economic actors, the acknowledgement that workers need special protection and have a right to collective interest representation, and widespread public ownership, especially in public services. As a result, European societies have reached a higher degree of equality than other developed economies in the post-war decades. Both have been put into question in recent decades of neoliberal restructuring. As a result of welfare cuts, the weakening of employment protection and trade union representation and the privatisation of industries, banks and public services, European citizens have become more dependent on market forces. Consequently, inequality has increased not only in terms of income but also with respect to access and quality of public services. Strangely enough the term ESM has been used by Europe's political elites to erode the very foundations of the ESM.

Notes

1. This is only partly true. In some regards, including the monetary policy of the European Central Bank (ECB), Europe is in fact more neoliberal than the United States (Hermann, 2007).
2. Not to speak of a comparison with developing countries which shows the limits of the concept of the social model that really only makes sense for the capitalist industrialised world from this perspective it may even be problematic to speak of a social model in the transforming countries in Central and Eastern Europe.
3. As it is oft the case in the United States.

References

Alber, J. (2006) "The European Social Model and the USA", *European Union Politics*, Vol. 7, No. 3, pp. 393–419.

Albert, M. (1993) *Capitalism vs. Capitalism. How America's Obsession with Individual Achievement and Short-term Profit Has led It to the Brink of Collapse* (New York: Four Walls Eight Windows).

Alesina, A. and Glaeser, E. (2004) *Fighting Poverty in the US and Europe* (Oxford: Oxford University Press).

André, C. (2006) *Welfare Regimes and A. Sapir's Paper* (Paper prepared Presented at the Workshop Concepts of the European Social Model, Vienna, 9 June).

Beckmann, M., Deppe F. and Mathis, H. (2006) "In schlechter Verfassung? Ursachen und Konsequenzen der EU-Verfassungskrise", *PROKLA,* Vol. 144, No. 3, pp. 307–324.

Bieler, A. (2007) "Der Kampf für ein soziales Europa: Gewerkschaften und die neoliberale Umstrukturierung der Europäischen Union", *Kurswechsel,* No. 1, pp. 6–15.

Bosch G., Lehndorff, S. and Rubery, J. (eds) (2009) *European Employment Models in Flux. A Comparison of Institutional Change in Nine European Countries* (Houndmills, Basingstoke, Hamsphire: Palgrave MacMillan).

Coates, D. (2000) *Models of Capitalism. Growth and Stagnation in the Modern Era* (Cambridge: Polity Press).

Deppe, F. and Felder, M. (1993) "Zur Post-Maastricht-Krise der Europäischen Gemeinschaft (EG)", *FEG-Arbeitspapier* No. 10 (Marburg: Philipps Universität Marburg).

Esping-Andersen, G. (1990) *Three Worlds of Welfare Capitalism* (Princeton, NJ: Princeton University Press).

European Commission (1994) *European Social Policy – A Way Forward for the Union. A White Paper* (COM (94) 333, Brussels).

European Commission (2000) *Communication from the Commission to the Council, The European Parliament, the Economic and Social Committee and the Committee of the Regions. The Social Policy Agenda* (COM (2000) 379 final, Brussels).

European Commission (2005a) *Communication from the Commission on the Social Agenda* (Com (2005) 33 final, Brussels).

European Commission (2005b) *European Values in a Globalized World. Contribution of the Commission to the October Meeting of Heads of State and Government* (COM (2005) 525 final, Brussels).

European Commission (2007) *Employment in Europe 2007* (Brussels).

European Commission (2008) *The Social Situation in the European Union 2007* (Brussels).

Ferrera, M. (1996) "The 'Southern Model' of Welfare State in Social Europe", *Journal of European Social Policy,* Vol. 6, No. 1, pp. 17–37.

Hall, P. and Soskice, D. (2001) "An Introduction to Varieties of Capitalism", in Hall, P. and Soskice, D. (eds) *Varieties of Capitalism. The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press), pp. 1–70.

Hermann, C. (2007) "Neoliberalism in the European Union", *Studies in Political Economy*, Vol. 79, Spring pp. 61–89.

Hofbauer, I. (2007) "Das 'Europäische Sozialmodell' als transnationales Modernisierungs- und Legitimationskonzept", *Kurswechsel*, No. 1, pp. 38–47.

Hyman, R. (2005) "Trade Unions and the Politics of the European Social Model", *Economic and Industrial Democracy,* Vol. 26, No. 1, pp. 9–40.

Huffschmid, J. et al. (ed.) (2005) *Economic Policy for a Social Europe. A Critique of Neo-Liberalism and Proposals for Alternatives* (Houndmills, Basingstoke, Hamsphire: Palgrave MacMillan).

Jessop, B. (2004) *The European Union and Recent Transformations in Statehood,* (Department of Sociology, Lancaster University), http://www.lancs.ac.uk/fass/sociology/papers/jessop-eu-transformations-statehood.pdf (accessed 22 January 2009).

Jepsen, M. and Amparo, S. P. (2005) "The European Social Model: An Exercise in Deconstruction", *Journal of European Public Policy,* Vol. 15, No. 3, pp. 231–245.

Krätke, M. (2005) "Hat das Europäische Sozialmodell noch eine Zukunft?", *Widerspruch*, Vol. 48, pp. 85–94.

Kronauer, M. (2007) "Exklusion und das europäische Sozial(staats)modell", *Kurswechsel,* Vol. 1, pp. 62–74.
Lewis, J. (1992) "Gender and the Development of Welfare Regimes", *Journal of European Social Policy,* Vol. 2, No. 3, pp. 159–173.
Lewis, J. (2007) "Arbeit, Familie und Gleichstellung. Politikentwicklungen auf europäischer Ebene", *Kurswechsel*, Vol. 1, pp. 48–61.
Mahnkopf, B. (2007) "Das Sozialmodell einer aggressiven Handelsmacht: Zur Funktionalisierung von Sozialpolitik für die Außenwirtschaftsstrategie der EU", *Kurswechsel*, Vol. 1, pp. 92–109.
Mettler, A. (2005) *Modernising the European Social Model, Lisbon Council* (Brussels), http://www.lisboncouncil.net/index.php?option=com_news&task=news_item&id=20&lang=de (accessed 20 January 2009).
OECD Online *Data Set Social Expenditure (Aggregated Data)*, www.oecd.org (accessed 20 December 2008).
OECD Online *Data Set Income Distribution – Poverty*, www.oecd.org (accessed 20 December 2008).
OECD Online *Data Set Average Annual Hours Actually Worker Per Worker*, www.oecd.org (accessed 20 December 2008).
Palast, G., Oppenheim, J. and MacGregor, T. (2003) *Democracy and Regulation: How the Public can Govern Privatised Essential Services* (London: Pluto Press).
Pontusson, J. (2005) *Inequality and Prosperity. Social Europe vs. Liberal America* (Ithaca, NY: Century Foundation).
Sapir, A. (2006) "Globalisation and the Reform of the European Social Models", *Journal of Common Market Studies*, Vol. 44, No. 2, pp. 369–390.
Wickham, J. (2005) The *End of the European Social Model – Before It Began?* (Paper presented at the 26th Conference of the International Working Party on Labour Market Segmentation, Berlin, 8–11 September 2005).

Part II

Case Studies

7
Privatisation in the Industrial Sector

Wlodzimierz Dymarski, Danes Brzica and Malcolm Sawyer[1]

7.1 Introduction

This chapter covers privatisation, which has occurred over the past three decades, in the industrial sector. The chapter is divided into a consideration of the experiences in the former socialist economies of the Central and Eastern European countries and then of the experiences in the predominantly capitalist economies of Western Europe. The intention is to convey the driving forces behind privatisation in each case and to review the effects of the privatisations on economic performance.

7.2 Privatisation in the industrial sector in Central and East European Countries

7.2.1 Basic differences between privatisation in Eastern and Western Europe

In the past two decades privatisation has been proceeding in Eastern and Western Europe. However, the course of the process has been substantially different in the 'new' and the 'old' market economies. The main reason was a fundamentally different share of the public sector between those economies when large-scale privatisation began. In the 'old' market economies the share of the public sector in production activities was moderate or small while a common feature of the former centrally managed economies was a strong dominance of the public sector over the private one. At the end of 1980s, the share of the public sector in the Gross Domestic Product (GDP) ranged from about 70 per cent (Poland) to some 95 per cent (Czechoslovakia and Hungary). No data on the share of public sector in employment for this time have been found for Hungary, Latvia and Lithuania. From among the remaining countries the smallest percentages of employment in public sector were in Poland (55.7 in 1989), Romania (66.0 in 1991) and Estonia (75.8 in 1989), while the highest ones were in Bulgaria and Czech Republic

(94.1 and 93.0 respectively in 1990).[2] The general effect of privatisation can be illustrated by the case of Poland. By the end of 2005, the shares of the public sector in gross value added and employment decreased to 24.8 and 28.3 per cent and the shares of industry to 24.4 and 17.1 per cent, respectively. However, the contribution of the public sector in manufacturing alone to total gross value added and employment was only 6.6 and 6.5 per cent respectively (Blaszczyk, 2007, p. 10).

The huge share of the public sector in Central and East European countries (CEECs) on the eve of their transformation determines the first principal difference between 1990s privatisation in these countries and privatisation in West European countries. The relative scale of privatisation in the former was much larger. For example, in Poland, the biggest economy among all ten CEECs, in 1990 there were 8.4 thousand of state-owned enterprises (Baltowski, 2002, p. 187), of which 2.8 thousand were in the industrial sector (Ministry of Industry and Commerce, 1994, p. 30, table 5). The sector was characterised by high concentration: 7.1 per cent of enterprises produced 44 per cent of total industrial output and employed 45.5 per cent of total employment (Baltowski, 2002, p. 187).

In the post-socialist countries the process of privatisation had two components. The first consisted in transforming state-owned enterprises into companies owned by private (natural and legal) persons (privatisation in the narrow sense). The second one consisted in creating a favourable legal framework and political climate for establishing new privately owned (domestic and foreign) businesses. To trigger both processes fundamental changes in the economic systems of CEECs were necessary. It was the second basic difference between privatisation in post-socialist countries and privatisation in the 'old' market economies. The former had to begin with implementing a totally new legal framework and building a market institutional infrastructure from scratch. In particular they had to:

- define the sphere of property rights in the system,
- establish a framework for exchanging those rights,
- ensure that the overall market structure and the rules of market exchange promote competition (Gray, 1992, p. 1).

The privatisation experience of the West European countries could be used to some extent, but the peculiarity of the circumstances demanded new solutions. It is worth pointing out that initially reformers did not always fully realize the necessity for an active role of governments in creation of market institutions. Some believed that institutions of market economy would emerge by themselves as result of privatisation (like 'mushrooms after rain'). This was the case in, for example, Poland.

The third fundamental difference was deep imbalance between a large 'supply' of firms to be privatized and an acute shortage of domestic capital

(Tomidajewicz, 2007). The common way to cope with this problem was opening privatisation to foreign investors. In addition, most governments (e.g., Bulgarian, Czechoslovak, Romanian and Polish) decided to adopt a kind of so-called voucher privatisation. Though such a scheme had not increased the volume of investment capital, it made it possible for ordinary citizens, who couldn't afford to take part in cash privatisation, to participate in the privatisation process and, in this way, to accelerate it. However, these measures had not prevented selling state-owned firms at relatively low prices, often below what they were actually worth. CEE governments, particularly those under the influence of neoliberal doctrine, were not opposed to such practices as they considered privatisation of state-owned firms as a *sine qua non* of the transition to a market economy. Furthermore, problems with high public deficits which they faced induced them to sell firms rather sooner (to increase current public revenues) than at a higher price.

7.2.2 Drivers for privatisation

Unquestionably the leading driver was a conviction (to great extent justified by former experience) that further attempts to improve performance of the economy through implementing some elements of market mechanism while preserving the dominance (or monopoly) of public ownership of enterprises would be as futile as previous ones.

The other driver for privatisation was related to the lack of managerial expertise and to a relative technical obsolescence of most (though not all) state-owned firms that made them incapable of effective competition on the open market. To survive they needed innovative managerial expertise and large capital investments in advanced technologies. Firms themselves, the just-emerging commercial banking sectors and the state budgets sunk in deep deficits were not able to finance them.

In CEECs, privatisation has been considered as a way to reduce the public deficit by reducing subsidies to inefficient state-owned firms on one side and replenishing public budget with revenues from privatisation on the other side. The best example of the former is voucher privatisation involving mostly low-performing enterprises, which would have otherwise been pressing the government for financial support to survive (Louzek, 2005, p. 18). Revenues from privatisation have been considered a supplementary source of financing public deficits. Nearly all amounts of revenues from privatisation of state-owned firms has been fed into state budgets. In Poland, for example, until 1997 the state budget was taking over the whole income from privatisation, and until 2002 only 3 per cent of it had been allocated for development goals. However, usually the share of privatisation revenues has made no more than several per cent of total annual public income, though in some cases (for example, in Poland in 1997–2001) the revenues were covering a considerable part of the state budget deficit or even exceeded it (Cieslukowski, 2009, p. 8).

Besides these economic reasons for privatisation, there were two others of a different character. The first was a political one. Privatisation has been considered by state authorities as a way to democratise the economy by enabling ordinary citizens to become shareholders. In addition, privatisation was considered as the only way to guarantee the irreversibility of the reform process. Voucher schemes were also considered as compensation to citizens for their contribution to the generation and increase of public wealth throughout the years of the socialist economy (Prohaski, 1998, p. 1) and as a vehicle for receiving political support in the next election. The same motivations underlay granting employees preferential rights to buy a definite part of shares at reduced price (or even get them for free). However, after an initial dispersion of ownership, reconcentration soon followed (Brzica and Olsson, 2001). Most people preferred certain, short-term income from selling shares or vouchers as soon as their prices had jumped up, rather than hope for higher income in the distant future. As regards voucher privatisation, it can hardly be recognised as successful. First, it involved mostly low-performing firms. Second, practice has confirmed that voucher privatisation funds (VPFs) "typically lack the economic incentive, power, expertise and capital to carry out the restructuring function of a holding company" (Ellerman, 1998, p. 2). Funds preferred selling firms to their restructuring. The funds were not able to increase the value of the assets they had received, and they also misused them. Managers of VPFs were interested more in multiplying their personal wealth than the assets of the funds. As a result, in Poland for example, assets that VPFs had received at the start decreased in value by more than half over nine to ten years.

The last but not least important driver was of an ideological nature. As the originators of the transition process were under the strong influence of neoliberal doctrine, they were convinced of the unarguable superiority of private ownership over public ownership. This is why decisions to privatise some firms were taken in spite of the absence of economic validity, that is, privatisation was becoming an end in itself. However, empirical research relating to the Czech Republic has shown that "when the major shareholder is a private company, such as a Czech closed-end fund, the adverse effects on performance were as bad as for a state controlled enterprise. Conversely, when the controlling shareholder is a public body, such as the local municipality, which has the motivation and ability to improve economic performance, performance was good" (Weiss and Nikitin, 2004a, pp. 16–17). Therefore, the notion that private firms tend to perform better than public firms probably does not always hold.

7.2.3 Changes in the role of industrial sector in Central and East European economies during transition[3]

At the beginning of systemic transformation the share of the industrial sector in GDP in most countries ranged from 35 to 40 per cent.[4] Exceptions

were Hungary and Estonia with only 21 and 28 per cent respectively, and Lithuania (56 per cent), Romania (50 per cent) and Poland (44 per cent). The shares of industry in total employment were, in general, considerably less though similarly diverse. The lowest shares (27.8–29.5 per cent) were observed in three Baltic Republics while the highest one (44.1) in Slovenia. In the remaining six countries the shares were between 34.5 and 36.9 per cent (see Tables 7.1 and 7.2).

After about 15 years of transition, the role of industry in the creation of GDP and in total employment has changed considerably in most CEECs. In most countries the shares of industry in GDP and employment have decreased and, as a rule, decrease in the former has been greater than in the-latter. The opposite has been the case for Bulgaria and Czech Republic. The latter has been the only country in which both shares have increased. The special case is Hungary where negative change in the share of industry in employment has been accompanied by positive change in its share in GDP.

Especially large decreases in industry contribution to GDP have taken place in Romania (by more than half), Lithuania and Latvia (by nearly half), and Bulgaria (by more than one-third). In three other countries (Slovenia, Poland and Slovakia) the industry share in GDP has decreased by more than

Table 7.1 Changes of industry share in GDP in CEE EU member countries during transition process

Country (year)	Industry share in GDP (%) Beginning of the transition	Industry share in GDP (%) 2006	Change (3)–(2) (percentage points)	Relative change (4):(2) (%)
(1)	(2)	(3)	(4)	(5)
Bulgaria (1991)	39.8	26.1**	–13.7	–34.4
Czech Rep. (1990)	36.7	41.9	+5.2	+14.2
Estonia (1993)*	28.3	25.2	–3.1	–11.0
Hungary (1991)*	21.0	23.0	+2.0	+9.5
Latvia (1990)	35.1	19.3	–15.8	–45.0
Lithuania (1991)*	55.7	30.4	–25.3	–45.4
Poland (1990)	44.1	32.6	–11.5	–26.1
Romania (1990)	49.9	24.6**	–25.3	–50.7
Slovakia (1992)*	35.2	26.0	–9.2	–26.1
Slovenia (1990)	33.4	23.7	–9.7	–29.0

Notes: *No earlier data available for the country.
**2005.
Source: Compiled from EBRD data. Column (4) and (5) – author's calculations

Table 7.2 Change of industry share in total employment in CEE EU member countries during transition process

Country (year)	Industry share in employment (%)		Change (3)–(2) (percentage points)	Relative change (4):(2) (%)
	Beginning of the transition	2006		
(1)	(2)	(3)	(4)	(5)
Bulgaria (1990)	36.6	23.1	–13.5	–36.9
Czech Rep. (1990)	36.2	40.0	+3.8	+10.5
Estonia (1990)	29.5	23.8	–5.7	–19.3
Hungary (1990)	36.6	32.3	–4.3	–11.7
Latvia (1990)	27.8	18.0	–9.8	–35.2
Lithuania (1992)*	28.9	19.7	–9.2	–31.8
Poland (1990)	36.3	29.3	–7.0	–19.3
Romania (1990)	36.9	31.4	–5.5	–14.9
Slovakia (1990)	34.5	29.0	–5.5	–15.9
Slovenia (1993)*	44.1	35.2	–8.9	–20.2

*No earlier data available for the country.
Source: Compiled from EBRD data. Columns (4) and (5) – authors' calculations

one fourth, and in Estonia by less than one-eighth. No common path of change within the whole period 1990–2006 has been observed nor for the first or for the second group of countries. Latvia and Romania have been the only countries with an almost regular (downward) trend.

Decreases in the shares of industry in total employment were highest in Latvia, Bulgaria, Romania and Lithuania (by around one-third as compared to the beginning of 1990), and then in Slovenia, Estonia and Poland (by about one fifth). The decline in the share of industry in GDP and total employment in CEECs should not be confused with absolute deindustrialisation. Rather it should be considered a symptom of economic progress.

7.2.4 Impact of privatisation on the development of industry

To assess the impact of privatisation on the development of industry one should distinguish between manufacturing and other industries. Generally positive impact of privatisation is unquestionable only with reference to the former. Privatisation has contributed to the considerable increase in dynamism and efficiency of manufacturing. Empirical studies have revealed that firm growth contributed to industry productivity more than sectoral

changes did (World Bank, 2008, p. 18). Fast development of manufacturing has significantly increased accessibility of manufacturing goods for domestic consumers. It also resulted in rapid growth of exports. Four CEECs were among the top fifteen which had the biggest world market share gain in exports of non-resource based manufactures in 1993–2001. These were Czech Republic (+0.4), Hungary (+0.4), Poland (+0.2) and Slovakia (+0.1 percentage point) (Kalotay, 2005). The enormous development of services and construction in CEECs would not be possible without the development of manufacturing (European Commission, 2004, pp. 6–7). As regards non-manufacturing industries, that is, mining, electricity, gas and water supply, the positive impact of privatisation boils down to regaining profitability, however, at the cost of huge increases in prices. It is worth remembering that when decisions on privatisation of these industries were taken, the official justification was that otherwise public authorities would be forced to increase prices.

Industry privatisation has been closely related to foreign direct investments (FDI). It is indisputable that without FDI privatisation on a mass scale would not have been possible because of shortage of domestic capital. However, the actual impact of FDI on economic development of CEECs and on manufacturing in particular is under dispute. One question seems to be beyond all doubt: as a rule, FDI in privatized industrial firms contributed strongly to their organisational and technological advancement and thus to the increase in their productivity and competitive position. Controversies have arisen about an indirect or spillover effect of FDI on domestic firms. However, recent research (Alfaro et al., 2007) shed some new light on the topic. First, it has been found that spillover effects manifest themselves not so much in horizontal (intra-industry) relations between foreign-owned and domestic firms operating in the same industrial sector, as through vertical (inter-industry) ones. While foreign-owned companies are preventing know-how leakage to potential competitors in their host country, they have a vested interest in sharing knowledge with their local suppliers in upstream sectors (backward linkages) and their – to a lesser extent – local buyers in downstream sectors (forward linkages).

Second, any impact the FDI exerts on domestic business through the creation of vertical linkages depends heavily on the financial market development level in the host country. When this market is not developed enough then capital accessibility to local firms is limited that inhibits development of vertical linkages. Let us add that similar influence may be exerted by an inadequate entrepreneurship policy of the government. As both factors, that is, financial market development and entrepreneurship policy vary among CEECs, this may explain why in some of them (for example in Poland) vertical linkages between foreign-owned and domestic firms have developed widely, while in others (for instance in Hungary) the former have constituted the so-called enclave economies.

Third, spillover effects appear to be larger when final goods produced by domestic firms and foreign ones are substitutes rather than complements. Possibly, this can be explained by limited compatibility of potentially complementary goods produced by both kinds of firms and by significant differences in prices of substitutive goods.

7.2.5 Impact of privatisation on employment

Privatisation has often been considered a main cause of emerging mass unemployment in transition countries. Actually, the question is not so simple. First, decreases in employment and thus the emergence of mass unemployment at the beginning of the transition period (that is in the early 1990s) was not so much a result of privatisation of industrial firms by itself, as a transition to the market economy in general. As soon as market forces had begun to exert a pressure on state-owned firms to become economically efficient and competitive, they had to start restructuring their employment as a *sine qua non* of their survival. At the very beginning of transition process a common feature of state-owned firms was large overstaffing inherited from a centrally managed economy. This primary overstaffing was augmented still more by a recession that had appeared in CEECs shortly before or just after the transition process had been launched. Employment restructuring had been usually initiated in firms which were still state owned though at this stage it had mainly defensive rather than strategic character. Those state-owned firms, which had not carried the restructuring through, collapsed and went bankrupt or, at best, fell into so deep debt that their later privatisation on favourable conditions became practically impossible. As a result, this then lead to even greater reduction of employment than that which was earlier needed for company survival. It is worth mentioning that governments of CEECs have chosen mostly a decentralized approach to restructuring state-owned firms, leaving this to new owners. This allowed the largest creditors to decide whether to restructure or liquidate acquired firms.

As regards the direct impact of privatisation of state-owned firms on employment, one must say that, as a rule, it did not lead to an immediate and considerable reduction in employment in acquired firms, but rather employment often fell as departing workers were not replaced. An immediate active reduction of employment through layoffs was on a limited scale and took place when a firm implemented strategic restructuring related to the adoption of new technologies. This was conditioned on legally binding rules of privatisation according to which a factory council composed of representatives of employees was a party to negotiations on terms of privatisation. As a rule, the council, with support of trade unions, managed to negotiate one of the following terms concerning employment policy after privatisation:

1. workers in employment at the moment of privatisation were guaranteed that they would not be dismissed during an agreed period (usually two to three years);

2. employees dismissed within a short period after privatisation were guaranteed an agreed severance pay (sometimes quite high);
3. combination of the above-mentioned terms, for example, guaranteed period for further employment and severance pay in the case of earlier dismissal (the most common solution).

In addition to this, in some cases, strategic investors guaranteed that wage rates will not be reduced or even committed themselves to increase them to an agreed level.

In the long run, changes in level of employment in privatised companies depends on three following factors:

1. The goals which a new owner of the firm had been guided by when taking it over. If the goal was its modernisation and development of production, then after initial reduction, employment then stabilised and could even increase. If, however, the enterprise had been taken over to eliminate a competitor or to drain off assets of the business, then employment went down dramatically forever, even to zero.
2. Effectiveness of pro-efficiency activities of new management of privatised enterprise. If these activities were highly successful and led to improving the competitive position of the business, then after an initial decrease in employment, in the long run it stabilized or even grew, but not, usually, reaching its pre-privatisation level.
3. Dynamics of domestic and foreign markets. Here a difference could be observed in the behaviour of private and state-owned firms. When demand was going down, the former have usually reacted by reducing employment while the later have kept employment unchanged or reduced it much less. The difference comes from the relatively strong position of trade unions in state-owned firms and a weak position in private ones. While the behaviour of state-owned firms could be considered as beneficial, from the point of view of the current situation on labour market, in the long run it resulted in deterioration of business efficiency and financial standing.

Empirical research does not confirm the postulated relationship between ownership composition and employment. In particular, there is no convincing evidence that increased profitability of firms controlled by foreign companies came at the expense of lower wages or lower employment levels (Weiss and Nikitin, 2004b, p. 31).

It is worth adding that in some countries (for example Poland, Slovakia and Bulgaria) the peak rates of unemployment at the beginning of the present decade coincided with the boom of new entrants into the labour market.

As regards the impact of privatisation on employment conditions, a clear symptom of decline has been observed in two countries, Poland and Slovenia, in which a strong sharp increase in the share of temporary contracts in total

employment has been observed since the end of the 1990s. In 2007, the shares reached 28.2 per cent and 18.5 per cent respectively, that places them second and fourth among EU-27, while in the remaining eight CEECs the share is two to ten times lower than the EU average. As regards employment protection legislation (EPL), data are available for only two years (1998 and 2003) and the four CEECs, which are OECD members (Czech Republic, Hungary, Poland and Slovakia). From these data follows that the unweighted average overall EPL index for the above-mentioned countries (EU4) did not change significantly between 1998 and 2003 (1.90 and 1.88 respectively). However, in both years it was considerably lower in EU4 (by 0.59 and 0.52 respectively) than the average for EU14 (excluding Luxembourg). Behind these differences in the overall EPL index lie huge differences in temporary employment protection. In the EU14, the average protection index was 2.23 in 1998 and 2.02 in 2003 while in EU4 it was only 0.75 and 0.81 respectively. No significant differences or changes have been found in regular employment protection, though the index was slightly higher in EU4.[5]

7.2.6 Privatisation and the position of trade unions

Private employers have a vested interest in the absence of trade unions from their firms because this enables them to flout provisions negotiated by trade unions in the framework of collective bargaining at the national or industry level. Absence or marginalisation of trade unions at the enterprise level dramatically reduces employees' capability to organise themselves and to negotiate successfully, and thus weakens their influence on employment and working conditions and wages as well as their capability to control the obeying of labour law. Moreover, the less effective a trade union is, the less attractive it is for employees to join.

However, though a negative impact of privatisation on trade union density ratio is indisputable, it has been not the only factor. In some countries, (for example in Poland) trade unions themselves have contributed significantly to the loss of their attractiveness for employees through direct and strong involvement in ideological disputes and battles among political parties. As a result, they have been seeing each other as opponents and competitors rather than partners in the fight for employees' rights and interests. It is not surprising that politicians try not only to make use of this but also to enhance trade unions' mutual aversion and even hostility.

In consequence of the above-mentioned factors, trade union membership as well as density ratio in CEECs fell down dramatically as compared to the pre-transition period. However, precise appraisal is difficult because of incompleteness and considerable diversity of data coming from different sources. Anyhow, without a risk of making considerable error, one can say that in most CEECs the fall in trade union density between the beginning of the 1990s and the first half of the present decade was within the interval of 40–80 percentage points.[6] Recent data show that the downward trend has

continued during the last years, at least in some countries. As a result, while in the pre-transition period the CEECs were among the most unionised countries, now in most of them the union density ratio is below the EU average, with the exceptions of Romania, Slovenia, Slovakia and Bulgaria. The industrial sector, that before privatisation was a bastion of trade unions in CEECs, has experienced even stronger de-unionisation. In six of nine countries (data for Bulgaria have not been found), union density in industry has fallen below the country average. The Baltic Republics have an extremely low unionisation level of industry (only 4–5 per cent, that is, about 2 to 4.5 times less than average). The only country where union density ratio for industry is above average is Slovenia.[7] Concerning the difference between union density in private and public sector, data has been found for only four countries. In Czech Republic unionisation of the private sector is somewhat higher (by circa one-tenth) than of the public sector; whereas in Hungary, Poland and Slovenia the union density ratio for the private sector is only a fraction of that for the public sector (circa one-third, a half and three fifth respectively).[8]

7.3 Privatisation in the industrial sectors in Western Europe

7.3.1 Public enterprise prior to the wave of privatisation

The significance of public enterprise in the market sectors of Western Europe during the 1980s and 1990s is indicated in Tables 7.3 and 7.4. There were evident significant differences between the countries of Western Europe. As a summary measure public enterprises accounted for around one-sixth of the market sector in 1982, falling to under one-eighth in 1991. By 1998 in the EU-15 the share was around 9 per cent on average (Table 7.4). Comparison among the second to fourth columns of Table 7.4 would suggest that public enterprises had tended to be more capital intensive than the private sector.

In the case of utility and network industries, there was a degree of uniformity in the sense that postal, telecommunications, gas and electricity, rail, and water were under public ownership in almost all countries, and the arguments for public ownership were based on the economies of scale and natural monopoly position and the importance of these industries for industrial development and living conditions. In Western European countries there had been a wide range of public ownership in the industrial sector with much diversity both in terms of between-country experiences in the sectors which were within public ownership and also in terms of the ways in which firms had come into public ownership. The data in Bortolooti and Milella (2006) Figure 7 indicates that over the period 1977–2004, proceeds from privatisation of manufacturing firms accounted for around one-eighth and transport firms around one-tenth of the total revenue from privatisation in Western Europe.

Table 7.3 Size of public enterprises in Western Europe, 1982–1991 (Public enterprises: Employment, value-added and gross capital investment as a percentage of the non-agricultural market sector)

	Average of three indicators			
	1991	**1988**	**1985**	**1982**
France	17.6	18.3	24.0	22.8
(West) Germany	11.1	11.6	12.4	14.0
Italy	19.0	19.6	20.3	20.0
United Kingdom	4.5	7.4	12.7	16.2
Spain	9.0	10.0	12.0	12.0
Portugal	20.7	24.0	22.7	23.9
Belgium	8.6	10.6	11.1	12.1
Netherlands	7.5	9.6	9.0	9.0
Greece	20.6	20.8	23.2	22.3
Denmark	11.5	11.9	11.4	12.0
Ireland	12.4	14.4	15.3	15.1
Luxembourg	4.4	4.9	4.5	5.0
EU-12	11.8	13.3	15.3	16.4

Source: Acocella (2005), p. 148, based on CEEP: L'enterprisé publique dans la Communite Economique Européene: Annuales

The pattern indicated in these tables for the 1980s and early 1990s had been broadly in place since the late 1940s. For example,

> [by] the 1940s, public enterprise accounted for about 10 % of GDP in most countries and, since they were in very capital-intensive sectors accounted for about 20 % of annual capital formation and less than 10 % of employment. Its scope did not change much over the next thirty years, and the slightly smaller shares recorded…for 1971 reflect the slightly smaller share of all transport, energy and communications in national output rather than any diminution of state and municipal enterprise (Millward, 2005, p. 173).

Although privatisation has been the dominant direction of travel since the early 1980s there were some significant extensions of public ownership in the industrial sector in the preceding decade. There was very extensive nationalisation in Portugal following the overthrow of the dictatorship. The 1974–1979 Labour government in the UK bought aerospace, shipbuilding and car firm British Leyland; in France in the first stages of the Mitterand

Table 7.4 Size of public enterprises in Western Europe, 1998

	Employment	Value added	Gross capital investment	Average of three measures		
		1998		1998	1995	1991
Germany	9.0	9.9	14.0	10.9	10.7	11.1
France	10.3	11.5	13.5	11.8	14.7	17.6
Italy	7.7	10.0	11.0	9.6	14.2	18.9
United Kingdom	2.5	1.9	2.5	2.3	2.7	4.4
Spain	3.9	3.3	5.0	4.1	8.0	9.0
Sweden	11.6	13.7	14.0	13.1	12.9	n/a
Austria	9.1	13.0	14.0	12.0	21.5	n/a
Belgium	10.4	11.3	10.9	10.9	11.6	11.0
Greece	12.3	13.5	17.0	14.2	15.4	20.2
Finland	10.9	10.5	11.4	10.9	17.6	n/a
Portugal	5.3	8.4	12.0	8.5	12.3	20.7
Netherlands	2.5	5.8	5.5	4.6	6.8	7.5
Denmark	6.1	7.5	9.9	7.9	9.7	11.5
Ireland	8.0	9.4	12.9	10.1	11.8	12.3
Luxembourg	5.3	5.3	6.4	5.7	6.4	6.4
EU 15	7.1	8.5	11.0	9.0	10.4	11.8

Source: C.E.E.P. (2000)

government companies such as Thomson-Brandt, CGE, Rhône-Poulenc, Compagnie de Saint-Gobain, PUK, Suez, Paribas and 36 banks were taken into public ownership in 1981–1983. In Greece, under the first elected government after the fall of the dictatorship in 1974, there was extensive nationalisation.

7.3.2 Background and drivers for privatisation

The major drive towards privatisation is usually seen as starting in the early 1980s, and then gathering pace during the 1990s. Wright (1994, pp. 2–5) wrote of six elements of "convergent pressures" relating to privatisation. The first element cited is "intellectual disenchantment with *dirigisme* and Keynesianism in many circles. Scepticism about the efficacy of state intervention has become manifest in many countries...". A second element "has been the changing nature of some industries," specifically technical changes which have weakened the extent of natural monopolies. This was also later associated with arguments which identified those parts of a production process which were subject to economies of scale, where there was

then an argument for public ownership or regulation, and those parts of a production process which were not subject to economies of scale and where there could be competition. "The third element in the general environment allegedly unfavourable to public enterprises has been the increasing internationalization of both product markets and financial markets." The fourth element which Wright cites is the removal of trade barriers within the European Union. "Although the existence of public enterprise is tolerated by the Treaty of Rome, there are aspects of the open market – monetary convergence, competition policy, public procurement policy – which logically prevent *dirigiste* governments from fully exploiting their public enterprises as instruments of industrial, regional policy or of purely political patronage." The fifth element is the perceived large capital requirements of major companies. The sixth and final element cited by Wright (writing in 1994) is the emergence and experience of the privatisation programme in the UK. With respect to France, Andre (2006) argues that "a major reason for implementing privatisations during this period was linked to the search for new sources of financing for the public budget. Privatisations have offered non-negligible resources for the budget: in 1987, the two thirds of these resources were used for reimbursing part of the public debt." A further reason was the search for funding for large investment to develop new techniques, to deal with globalisation and increased foreign competition. Privatisation also was seen to enable firms to enter into strategic alliances with foreign partners. A further reason was that "privatization was presented by the government as a way to democratize the economy, as it would allow the development of small shareholders among the population" (Andre, 2006, pp. 6–7).

The objectives of privatisation have been variously summarised but would usually be taken to include the following (see, for example, Richardson, 1994 for the UK): The drivers of privatisation have included the desire to reduce government involvement in industry, and the perception that efficiency could be improved. Further factors have included the reduction of the government borrowing requirements, and the weakening of the power of trade unions which were seen as strong in the public sector. Finally the promotion of share ownership, attempts to develop stock markets and the political advantages to right-of-centre parties being associated with private ownership.

These objectives can also be related to the pressures towards privatisation. For example, in the early 1980s under the impact of monetarism, much attention was paid to restraining the budget deficit, and under the then prevailing accounting rules privatisation receipts were recorded as negative expenditure, thereby reducing the recorded budget deficit in the year in question. But, since privatisation meant that the government no longer received the profits of the public enterprise, privatisation swapped a capital receipt now for lower government receipts in the future. The overall effect of the privatisation of industrial sector companies on the government

finances is likely to be negative. If a 'fair' price is extracted for the privatised company then the gain in receipts will be balanced by the loss of future income (the sale price being the discounted value of future income). However, it was often the case that the realised price was below that.

The financial problems of the nationalised industries in the 1970s, often arising from controls over their prices as part of an anti-inflationary policy, the drive to reduce trade union power and the aforementioned drive to reduce budget deficits, are undoubtedly main forces behind privations in the UK during the 1980s. Two others though should be mentioned. First, there were perceptions, often fostered by the right, that the public enterprises were lacking in efficiency and the drive for profits, and indeed that such enterprises were side-tracked in supporting other social objectives as indicated above. Arguments have raged over the relative efficiencies of public and private in this context but surveys such as Millward (2005) find that "there is no evidence of a poor productivity growth record for state enterprises in Europe in the second half of the twentieth century" (p. 281). Productivity growth often picked up as public companies were prepared for privatisation but that did not continue after privatisation (see, for example, Martin and Parker, 1995). The exhaustive study by Florio concludes that it has "been unable to find sufficient statistical macro or micro evidence that output, labor, capital, and total factor productivity (TFP) in the United Kingdom increased substantially as a consequence of ownership change at privatization compared to the long-term trend. There are exceptions for some firms and some periods, but overall a significant productivity shock is lacking" (Florio, 2004, pp. 343–344).

The other aspect to mention is the promotion of wider share ownership, which in the case of the UK at least also related to gaining political advantage (those buying underpriced shares in privatised companies could reap substantial profits through resale, and the more general feeling that property owners tended to vote right rather than left). However, the immediate success of extending share ownership followed by a concentration of ownership is illustrated in the following. "We examine the effect privatizations have had on the pattern of share ownership by individuals and institutional investors and find that privatizations have dramatically increased the number of shareholders in many countries. However, the extremely large number of shareholders created by many share issue privatizations are not a stable ownership structure" (Boutchkova and Megginson, 2000, Abstract, p. 31).

7.3.3 Forms of privatisation and issues

Privatisation has generally taken one of three general forms. First, floating of shares on the stock market through Initial Public Offering (IPO). In the UK, this route was followed for the sale of all the large public utilities, though less frequently for the sale of other companies. Second, the sale of a company to a private company and third, the use of management buy-outs.

Acocella (2005) reports for five countries (Italy, Spain, Germany, France and UK) that just over two-thirds of privatisation receipts over the period 1992–2000 came from public offerings and the remaining one-third from private sales.

The IPO route has often been associated with seeking to widen share ownership. That apart, the issues under the different forms of privatisation are rather similar. Two attract our attention here. The first concerns whether the public sector receives a 'fair' price for the assets which are being sold.

Vickers and Yarrow (1989) estimated that during the first four to five years of UK privatisations, when the sale was at a set price the undervaluation of the share price was over 20 per cent when judged by the share price at the end of the first day of trading relative to the offer price (see also Curwen and Holmes, 1992; Florio, 2004, p. 347).

In those cases where a company was directly sold to another company on privatisation it can be more difficult to determine whether there has been underpricing. However, there is some evidence of the acquiring company 'getting a bargain'; often associated with their ability to realise assets, particularly property, which were peripheral to the main business.

The second issue relates to the eventual ownership of the privatised companies. It has already been remarked that when individuals were given preference in the purchase of shares in privatised companies, many sold quickly (to their financial benefit when the shares were underpriced), and the involvement of small shareholders in the privatised companies declined over time. After a decade or so of privatisations in the UK, the proportion of shares held by beneficial owners of the privatised companies included pension funds 27.6 per cent (as compared with 33.0 per cent in all companies), insurance companies 12.4 per cent (15.7 per cent), individuals 24.5 per cent (20.3 per cent), unit trusts 4.5 per cent (5.9 per cent) and overseas 8.3 per cent (12.1 per cent) (HMSO, *Economic Trends,* October 1993). There were estimates that the number of shareholders in the adult population rose by the order of 5 to 7 per cent to around 20 per cent, but with the increase largely coming from shareholders with a small holding of shares in one or two companies.

The initial sale of shares in privatised companies has often been focused on individuals rather than institutions and on domestic residents rather than overseas residents. As suggested above, individuals have often then sold their shares to institutions. It has been a feature of many privatisations that the company concerned has after some time been acquired by another, usually multinational, company. "By far more relevant to a discussion of trends in shareholding was the growth in the weight of the foreign sector, fund managers, insurance companies, and pension funds in total ownership. Thus, the direct beneficiaries of the initial underpricing of shares of privatized firms are a thin majority of the British population and a group of large financing institutions, both national and international" (Florio, 2004, p. 346).

7.4 Concluding remarks

It is evident that there were many motives lying behind privatisation of firms in the industrial sector (as with other firms) in Europe with some differences between East and West resulting from the fact that in the former privatisation was an integral part of fundamental systemic transformation. However, as the transformation of CEECs had been progressing, a convergence in drivers of privatisation was observed. In both parts of Europe, the often-mentioned one is a pressure to reduce budget, though this relies on an accounting practice which regards privatisation revenues as akin to negative expenditure. Further it does not allow for the future reduction in government revenues from the profits of the once state-owned enterprises. The evidence cited above suggests frequent underpricing of the sale price of state-owned enterprises which therefore involves losses to the public exchequer, and windfall gains for the purchasers of the privatised companies. The attempts to widen share ownership through privatisation has had rather limited effect according to the evidence above. The most notable outcome of privatisation in terms of ownership of the former state-owned enterprises is the acquisition by foreign owners – perhaps an unsurprising outcome in light of globalisation. In CEECs, privatisation has strongly contributed to sharp decline in trade unions' density ratio and their bargaining power.

Notes

1. Section 7.2 written by W. Dymarski with cooperation of D. Brzica; section 7.3, Introduction and Concluding remarks by M. Sawyer.
2. Figures are European Bank for Reconstruction and Development (EBRD) rough estimates (see EBRD, 2008) except the share in employment in Poland, which comes from the CSO (1991).
3. The following analysis is based on EBRD data (EBRD, 2008) that has been the only available source covering the whole period of transition. However, it should be pointed out that data on industry shares in GDP and employment coming from other sources may differ (sometimes significantly) from those estimated by EBRD.
4. Industry includes mining, manufacturing and electricity, power and water supply. The average share of industry plus construction in value added in present ten CEE member states amounted to 46 per cent and in employment to 40 per cent (1990) (see World Bank, 2008, p. 15, fig. 10).
5. Averages of indexes are authors' calculation based on OECD data (OECD, 2008) (http://stats.oecd.org/wbos/Index.aspx?DatasetCode=KEI).
6. See, for example, Visser, 2006; European Commission, 2006, p. 25; Carley, 2005.
7. European Commission, 2006, pp. 25–26; Mihailova, 2008; Preda, 2003.
8. Beneyto, 2008, pp. 65–66, data for 2002–2003.

References

Acocella, N. (2005) *Economic Policy in the Age of Globalisation* (Cambridge: Cambridge University Press).

Alfaro, L., Chanda, A., Kalemli-Ozcan, S. and Sayek, S. (2007) "How Does Foreign Direct Investment Promote Economic Growth? Exploring the Effects of Financial Markets on Linkages", *NBER Working Paper,* 12522, September 2006 (revised on 12 June 2007), http://www.nber.org/papers/w12522.pdf (accessed 9 November 2008).

Andre, C. (2006) *Privatizations in France*, www.presom.eu

Baltowski, M. (2002) *Przekształcenia własnosciowe przedsiebiorstw panstwowych w Polsce* [Ownership transformation of state-owned enterprises in Poland] (Warsaw: Polish Scientific PWN).

Beneyto, P. J. (2008) "El sindicalismo español en perspectiva europea: de la anomalía a la convergencia", *Cuadernos de Relaciones Laborales*, Vol. 26, No. 1, pp. 57–88.

Blaszczyk, B. (2007) "Mapa sektora prywatnego w Polsce jako wynik polityki prywatyzacyjnej" [The map of private sector in Poland as a result of privatization policy], in *Przedsiebiorstwa sektora prywatnego i publicznego w Polsce (1999–2005)* [Private and public sector enterprises in Poland (1999–2005)] (Zeszyty BRE Bank – CASE No. 89/2007, Warsaw).

Bortolotti, B. and Milella, V. (2006) "Privatization in Western Europe: Stylized Facts, Outcomes, and Open Issues", *FEEM Nota di Lavoro*, 124, http://www.feem.it/Feem/Pub/Publications/WPapers/default.htm

Boutchkova, M. K. and Megginson, W. L. (2000) "Privatization and the Rise of Global Capital Markets", *Financial Management,* Winter, Vol. 29, No. 4, pp. 31–76.

Brzica, D. and Olsson, M. (2001) *Corporate Governance in Transitional Economies: The Case of the Czech Republic* (Paper Presented at the ACE Workshop on Corporate Governance and the Accession Countries, Portoroz, Slovenia, June).

Carley, M. (2005) *Trade Union Membership 1993–2003* (EIROnline), http://www.eurofound.europa.eu/eiro (accessed 12 November 2008).

C.E.E.P. (European Centre of Employers and Enterprises providing Public services) (2000) *The Development of Enterprises of Public Participation and of General Economic Interest in Europe since 1996* (CEEP Statistical Review).

Cieslukowski, M. (2009) *Privatization in Poland and the Formation of the European Social Order*, in Tomidajewicz, Janusz J. (ed.), PTPN, Poznan (forthcoming bilingual Polish/English book).

CSO (1991) *Statistical Yearbook 1991* (Warsaw: Central Statistical Office).

Curwen, P. and Holmes, D. (1992) "Returns to Small Shareholders from Privatization", *National Westminster Bank Quarterly Review*, February.

EBRD (2008) *Economic Statistics and Forecasts*, http://www.ebrd.com/country/sector/econo/stats/index.htm (accessed 2 December 2008).

Ellerman, D. (1998) "Voucher Privatization With Investment Founds: An Institutional analysis", *Working Paper,* No. 167, March (The William Davidson Institute at the University of Michigan Business School).

European Commission (2004) *Fostering Structural Change: An Industrial Policy for an Enlarged Europe* (Communication from the Commission, COM (2004) 274 final, Brussels, 20 April 2004).

European Commission (2006) *Industrial Relations in Europe 2006* (Directorate-General for Employment, Social Affairs and Equal Opportunities).

Florio, M. (2004) *The Great Divestiture: Evaluating the Welfare Impact of the British Privatizations, 1979–1997* (Cambridge, MA; London: MIT).

Gray, C. W. (1992) "The Legal Framework for Private Sector Activity in the Czech and Slovak Federal Republic", *Policy Research Working Paper, WPS1051* (The World Bank).

HMSO (1993) *Economic Trends* (London, October).

Kalotay, K. (2005) *The Role of Foreign Direct Investment in Transition. After Fifteen Years of Market Reforms in Transition Economies: New Challenges and Perspectives for the Industrial Sector* (Geneva: United Nations Commission for Europe, UN Conference for Trade and Development, 24–25 May).

Louzek, M. (2005) "Objections to Voucher Privatization: Not So Valid?", *Beyond Transition*, October–December, Vol. 16, No. 4, p. 18.

Martin, S. and Parker, D. (1995) "The Impact of UK Privatization on Labour and Total Factor Productivity", *Scottish Journal of Political Economy*, Vol. 42, No. 2, pp. 201–220.

Millward, R. (2005) *Private and Public Enterprise in Europe: Energy, Telecommunications and Transport, 1830–1990* (Cambridge: Cambridge University Press).

Mihailova, T. (2008) *Representativeness of European Social Partner Organizations: Manufacture of Sugar – Bulgaria,* http://www.eurofound.europa.eu/eiro/studies/tn0707037s/bg0707039q.htm (accessed 16 November 2008).

Ministry of Industry and Commerce (1994) *Raport o stanie polskiego przemysłu w roku 1994. Część I. Ogólna* [Report on the state of Polish industry in 1994. Part I. General] (Warsaw).

OECD (2008) *OECD StatExtracts, Data Set: Strictness of EPL*, http://stats.oecd.org/wbos/Index.aspx?DatasetCode=KEI (accessed 15 November 2008).

Preda, D. (2003) *The Development and Current Situation of Trade Unions*, http://www.eurofound.europa.eu/eiro/2003/07/feature/ro0307101f.htm, (accessed 16 November 2008).

Prohaski, G. (1998) *Privatisation through Investment Vouchers in Bulgaria, A Review of Bulgarian Privatization*, (OECD with cooperation of Bulgarian Centre for Economic Development, OECD Headquarters, 23–24 November).

Richardson, J. (1994) "The Politics and Practice of Privatization in Britain" in V. Wright (ed.), *Privatization in Western Europe* (London: Pinter).

Tomidajewicz, J. (2007) *Privatization Issues in Central European Countries* (the case of Poland) (presentation to the PRESOM Conference, Lubljana, 29–30 June).

Vickers, J. and Yarrow, G. (1989) *Privatisation: An Economic Analysis* (Cambridge, MA: MIT Press).

Visser, J. (2006) "Union Membership Statistics in 24 Countries", *Monthly Labour Review*, January, Vol. 129, No, 1, pp. 38–49.

Weiss, A. and Nikitin, G. A. (2004a) "Ownership Composition, Corporate Governance, and Performance: Evidence from the Czech transition", *Beyond Transition*, October/November/December, Vol. 15, No. 1, pp. 16–17.

Weiss, A. and Nikitin, G. A. (2004b) "Foreign Portfolio Investment Improves Performance: Evidence from the Czech Republic", *Topics in Economic Analysis & Policy*, Vol. 4, Issue 1, Article 15.

World Bank (2008) *Unleashing Prosperity. Productivity Growth in Eastern Europe and the Former Soviet Union, Overview* (Washington, DC).

Wright, V. (1994) "Industrial Privatisation in Western Europe: Pressures, Problems and Paradoxes", in V. Wright (ed.) *Privatization in Western Europe* (London: Pinter).

8
Liberalisation in Network Industries

David Flacher, Hugues Jennequin and Mehmet Ugur

8.1 Introduction

Network industry liberalisation is usually introduced to promote competition and achieve efficiency gains in sectors with some degree of natural monopoly. Liberalisation is usually followed with sector-specific regulation, which aims to ensure competition through monitoring of certain target variables such as price, market concentration, investment, etc. In Europe, telecommunications was the first industry to be liberalised, followed progressively by water, electricity, gas and railways.

The main characteristics of the liberalisation process in the European Union (EU) network industries can be summarised as follows: (1) progressive market opening that allows for free entry of potential providers and enables consumers to switch between competing retail suppliers; (2) network unbundling in order to foster competition on downstream activities that are less characterised by economies of scale as well as to increase price/cost transparency and to facilitate monitoring of compliance with competition rules; and (3) establishment of independent national regulatory authorities (NRAs) complemented by EU-level regulatory bodies whose role is implementation and coordination of the liberalisation process.

In this chapter, we aim to establish whether liberalisation and accompanying regulatory arrangements have delivered the expected efficiency gains. In Section 8.2, we discuss the theoretical issues and demonstrate that 'marketable' yet simplistic arguments in favour of liberalisation tend to ignore a complex set of issues such as imperfect competition, imperfect information, and second-best consequences that are highly likely to limit or prevent the achievement of efficiency and welfare gains. In Section 8.3, we review the empirical findings. We find that the partial evidence in support of the liberalisation agenda in the *telecommunications* and *energy* sectors is overshadowed by the evidence suggesting that liberalisation and regulation have usually failed to deliver the expected efficiency gains. In Section 8.4, we narrow our focus to investment and innovation in the

telecommunications and electricity sectors. The evidence here suggests that liberalisation may be conducive to incremental innovation/investment in sectors where maintaining market shares and/or mark-ups is a significant concern. However, liberalisation has either negative or ambiguous effects on investment in radical breakthroughs, and it does not necessarily lead to optimal investment when compared with public monopolies. Finally, in the conclusion (Section 8.5) we summarise the main findings and highlight the implications for European integration.

8.2 The economics of liberalization: A pandora's box

The theoretical argument that underpins the liberalisation of network industries in Europe and other countries rests on 'welfare gains' that competition is expected to deliver. The reasoning is quite simple: since perfect competition is theoretically optimal in terms of global welfare and efficiency, welfare can only improve if one moves away from monopoly and gets closer to perfect competition. This theoretical reasoning is often considered to be valid at micro-, meso- and macro-economic levels. But is this necessarily true?

If one subscribes to a neoclassical conception of welfare, it is possible to demonstrate that the total unweighted social welfare is the highest in the case of perfect competition. It is also true that *perfect competition* is conducive to *allocative efficiency*. However, not only are the conditions for achieving Pareto efficiency numerous but also this type of efficiency is blind to the type of social welfare function. For example, the case in which one agent has everything and the others have nothing is Pareto-efficient if it is impossible to increase the welfare of the destitute without making the omnipotent worse off. As such, it overlooks issues such as social cohesion, regional disparity and planning, inter-temporal choices and strategic considerations that may be related to the policy choice itself.

Despite this limitation and despite persistent market failures, a pro-liberalisation argument tends to be appealing because it essentially represents a 'bet' on the *dynamic* properties of competition – a bet that the dynamic gains in the long run (i.e., gains due improvements in productivity and quality, higher levels of differentiation and innovation, and lower prices, etc.) would exceed any possible adjustment costs and efficiency loss in the short term. Perfect competition is supposed to have the necessary dynamic properties for dynamic efficiency because of the product and process innovation as well as organisational innovation that it induces. Indeed, perfect competition can generate new types of products, markets and firms, which would be more efficient than monopolist incumbents. Stated differently, perfect competition may instigate a virtuous circle: it may stimulate innovation that would lead to efficiency gains and cost reductions that, in turn, instigate further competition. And this is in contrast to a monopolist

market, in which the incumbent can adopt a cost structure that justifies *a posteriori* the 'natural' characteristic of the monopoly.

Yet, this seemingly appealing argument for liberalisation and privatisation is based on a fragile theoretical and empirical basis. The theoretical basis is fragile because competition in practice does not correspond to the model of perfect competition assumed in the theory. In fact, the necessary conditions for perfect competition are so extensive and demanding that they are akin to conditions for a 'perfect social planer', who can achieve productive and allocative efficiency irrespective of ownership type and market structure. The empirical basis is also fragile because of imperfect competition including (1) strategic interactions and coordination failures (leading, for instance, to races towards the lowest common denominator with respect to health safety and environmental standards); (2) high levels of externalities; (3) sub-optimal production caused by differentiation under monopolistic or oligopolistic competition.

In this context, liberalisation can only be considered as a step towards achieving the *second best*, that is, achieving allocative efficiency under constraints. But once again, the theory of second best (Lipsey and Lancaster, 1956) demonstrates that gradual liberalisation and removal of anti-competition distortions in a sector can be counterproductive in terms of Pareto efficiency if other economic sectors are not competitive. Moreover, a partial movement towards the first best may not even guarantee an improvement in welfare if it affects existing distortions (Lipsey, 2007). A third issue is that "partial policy measures which eliminate only some of the departures from the optimal arrangement may well result in a net decrease in social welfare" (Baumol, 1965, p. 138).

The likely failure of second-best policy actions to deliver the expected welfare gains is because the sectors characterized by suboptimal resource allocation send 'bad' demand and price signals to the perfectly competing ones, inducing in turn suboptimal resource allocation in the competitive sectors. Therefore, as Lipsey (2007) points out, even if computable general equilibrium simulations point to welfare and/or efficiency gains from liberalisation, these findings may be either over-optimistic or totally misleading as they ignore the complications highlighted by the theory of second best. Market-opening reforms in European network industries do not constitute a move from the second to the first best, not only because of the continuity of the distortions in the rest of the economy, but also, and more importantly, because of the persistence of the distortions within the liberalised industries themselves. These persistent distortions may be due to large market shares controlled 'naturally' by a small number of players (because of scale and scope economies, high level of sunk costs, and externalities) and due to often low demand and supply elasticities.

Given these considerations, liberalisation and competition can be considered as an intermediate target for eventually achieving efficiency (mainly

allocative and productive efficiency) gains, but not as an indicator of efficiency itself. Moreover, it is theoretically possible to argue for alternative tools such as industrial policy to achieve the intermediate target. There are various performance indicators that can be monitored to check if competition (as an intermediate target) is achieved (see OECD, 2003). These indicators mainly deal with market shares, entry barriers and the number of operators. However, and as stated above, achievement of these targets must not be confused with the achievement of the final aim of liberalisation and regulation – that is improvement in efficiency and welfare in the short, medium and long term. Even if we agree on the choice of indicators, there are still further questions to be addressed: How should the impact on distributive efficiency be assessed? How can we take into account universal service and impact of liberalisation on regional development? What is the impact of liberalisation on regional distribution of knowledge-intensive services (such as telecommunications)? How does it affect the dynamics of regional development, a region's capacity to attract economic activities, and thus the development of the whole economy? As indicated in Martin and Rogers (1995), Fujita et al. (1999), Baldwin et al. (2003) and Jennequin (2005), one needs to take into account not only the level of competition but also the impact of liberalisation on negative and positive externalities caused by particular deployment and distribution of infrastructure across the country and the development of knowledge-intensive services at regional levels.

In this perspective, analysing the impact of liberalisation and privatisation not only on the level, but also on the structure of investment is particularly important. Yet this issue is usually not taken into account by regulators even though its is well known that the level of investment per se cannot always be considered as an indicator of efficiency in itself. Indeed, higher investment does not necessarily mean choosing the best opportunities to invest nor does less investment mean rationalisation, productivity gains or simply that a period of investment has ended. We must also consider whether change in investment may be due to changes in equipment and raw material prices or changes in economic conditions in general. We must also consider whether increased investment is due to increased demand following the fall in consumer prices, which, in turn, may or may not be due to market opening and liberalisation.

Once this is acknowledged, a large set of questions needs to be addressed. For example, does the sector focus more on investment in research and development (R&D) or commercial investments? Does it prioritise investment in services or in infrastructure development? Does the nature of employment change and are these changes linkable to specific investments or activities? Can these changes be linked, qualitatively or quantitatively, to the regulation process? Are the trends similar to the ones observed in other countries? Indeed, if similar countries are behaving differently (for instance, regarding investment) these differences could be analysed as

strategy changes due to regulation policy choices. However, studying all these aspects is quite difficult since data is not necessarily available.

In the light of the above, we can thus summarise the three significant gaps in the theoretical argument in favour of liberalisation. The first reality gap is due to the failure to acknowledge the difference between perfect competition as the theoretical, first-best environment and the second-best competition we actually have after liberalisation and regulation. The second reality gap arises from the simplistic approach to the measurement of competition as well as its impact on welfare and efficiency gains. Finally, the third gap results from overlooking the complex relationship between allocative, productive and distributive efficiency, leading potentially to incorrect choice of regulatory targets and instruments.

Of course, these conclusions do not suggest that the alternatives to liberalisation (that is industrial policy, regulation of the natural monopoly, or the existence of a benevolent social planner) are necessarily better in terms of delivering welfare and efficiency gains. What these conclusions imply is that attempts at presenting liberalisation as the best option for securing efficiency and welfare gains in network industries quite often verge on ideological attempts at short-circuiting the debate. In what follows, we will examine the empirical findings to establish the extent to which such a short-circuiting risk does indeed exist.

8.3 The empirical evidence: Does liberalisation and regulation deliver?

The empirical literature examine the link between the performance of the sector (measured through employment, investment, productivity, price levels, and etc.) and the level of reform in the sector (measured by the number of operators, new entrants' market shares, the level of privatisation of the incumbent, and the type of regulation implemented). An important intervening variable in this link is the sector-specific regulator – an agent charged with the task of achieving competition as an intermediate target. To assess the effectiveness of the regulator in ensuring competition, two types of indicators are used: *ex ante* and *ex post* indicators (Estache and Martimort, 1999). While *ex ante* indicators measure the extent to which regulators are equipped with adequate qualities for effective regulation, *ex post* indicators measure the extent to which the regulator achieve the intermediate target (that is, effective competition) and the final aims (that is, productive and allocative efficiencies).

In the case of *ex ante* indicators, using Copenhagen Economics indicators (2005), Ugur (2007a, 2007b) shows that measures of regulators' strengths/resources (that is, indicators of regulators' independence, budgetary allowance, personnel, power sharing with other governmental bodies, and etc.) and measures of competences (that is, indicators of regulators' powers to

monitor/regulate prices, network access, investment or service quality, and etc.) are quite low in most of the EU-15 countries. These *ex ante* measures of regulatory quality are usually less than 50% of the optimal level that can be expected and vary significantly from one country to the other. In addition, the strengths/resources and competence indicators are not correlated significantly or the coefficients of correlation are very low when significant. These shortcomings, combined with the bargaining-based decision process in the EU, increase the risk of regulatory capture and limit the expected positive effects of the liberalisation process.

In the case of *ex post* indicators (that is, those reflecting the effects of regulation on sector performances), Ugur (2007a, 2007b) appears to be also very sceptical. Even though telecommunications prices have fallen, this trend seems to be less clear in the electricity sector and opposite trends can be seen in the gas sector from 1997–2005. Furthermore, member states with higher levels of regulatory activity in 2003 did not necessarily enjoy lower prices for gas, electricity or telephone calls in 2005. According to ERGEG (2006) and EU Commission (2007), these results can be due to the evolution of oil prices, bottlenecks in network capacities, incumbent's market power (markets remained widely concentrated in spite of liberalization and *ex ante* regulation) or the existence of long-term purchase or sale contracts.

With the exception of oil price trends, the remaining causes are all related to the imperfect nature of the competition in liberalised markets. The combination of liberalisation and significant market power, coupled with low demand elasticities, limit the fall in prices and lead to higher levels of price volatility (Borenstein et al., 2002; Bushnell and Mansur, 2005). With respect to limited price falls, Buehler (2005) reports that unbundling of an integrated network industry may increase retail prices whereas freer entry may reduce them – with the overall effect remaining uncertain. Liberalisation and competition should also imply price convergence within the EU. But once again, the results are rather unclear. Similar sceptical conclusions are deduced for productivity gains even if the latter could be more the result of technological change rather than the effect of rationalisation induced by liberalisation.

With respect to telecommunications, other works provide ambiguous results and appear to be challenging the idea that liberalisation and competition-oriented regulation would have (only) positive effects. For instance, contrary to Li and Xu (2002) and Bortolotti et al. (2002) findings, research by Boylaud and Nicoletti (2001) shows, using 22 OECD countries, that partial or total privatisation does not lead to higher efficiency in telecommunications in terms of productivity or price. With respect to developing countries, Wallsten (2001), reports similar results, except when a sector-specific regulation is implemented. In return, privatisation appears to enhance firm profitability: However, examining 31 companies in 25 countries, Bortolotti et al. (2002) show that firm financial performance tends to

be higher even when under partial privatisation. With respect to employment effects, Bortolotti et al. (2002) as well as Li and Xu (2002) report that privatisation has led to a fall in employment in the telecommunications sector. Ugur (2007a) also reports a fall in employment in the European telecommunications as well as gas, electricity and water supply sectors. The fall in employment holds both in absolute terms as well as relative to total industry employment.

Ambiguity is also observable in findings concerning the effects of regulation type. While the rate of return (ROR) regulation is found to cause overinvestment (Averch and Johnson, 1962), the price cap regulation does not have any impact either on investment (Chunrong and Sappington, 2002) or on production, employment or productivity of the sector (Bortolotti et al., 2002). The existence of a national regulatory authority (NRA) would have a positive effect on production but no effects on other indicators. Finally, the impacts of developing effective competition on sector performance are also ambiguous. According to Boylaud and Nicoletti (2001), competition would have positive effects on prices and productivity. For Li and Xu (2002), the relation between competition and productivity is not significant. The link between competition and the quality of services appears to be negative when studied in detail, as in Uri (2003). Competition is found to have a positive effect on employment in Li and Xu (2002) but a negative effect in Bortolotti et al. (2002).

Studies on other sectors also report adverse effects or ambiguous results at best. For example, Moore (1975) shows that, in the USA, regulation was unsuccessful in lowering electricity prices below monopoly levels. Using commission man-hours of regulation per individual in each state in 1947, 1953, 1960 and 1966, he also reports that the situation was not improving over time – that is, regulator's learning process is not necessarily leading to better regulatory outcomes. Similarly, Upadhyaya and Raymond (1994) use cross-sectional US data for 1922, 1927 and 1932 and report that regulation remains ineffective in lowering the price of electricity. There are similar findings from time-series US data, too. For example, Upadhyaya and Mixon (1995) use national US time-series data for 1918–1953 and regress the electricity prices on four variables: population growth, hydro-power generation, technology and regulation. They report that all variables except regulation are significant determinants of prices in that period. The parameter for regulation has the correct sign (that is, it is negative), but it is statistically insignificant. Mitra et al. (2005) also report that the Energy Policy Act of 1992 and the Federal Energy Regulatory Commission Orders of 1996 did not lead to production or cost efficiency in the US electricity market between 1983–1999. Finally, Esnault (2006) points out that the finance-led organisation of the sector resulting from liberalisation policies has introduced many risks: price volatility, quotations manipulation, and reduced relevance of the price signals as conduits for efficiency gains – mainly due to obsession with share value maximisation (Esnault, 2006; Bouttès, 2005).

In the rail transport sector, the modality and level of market opening differs significantly between member states. Nevertheless, the liberalisation reforms have been followed by an evident trend towards market concentration through mergers and acquisitions. This is likely to increase market power. However, this may be counterbalanced by the emergence of 'European' strategies that enable some operators to operate in several national markets. This, however, will reduce market power only if it is associated with new entry, which is not the case. According to Scherp (2005), high market share and strong capital base of the national incumbents make new entry difficult – as was the case with the 'European Bulls' alliance set up by five new entrants. The findings above are closely related to the prediction of the second-best theory – namely that partial removal of existing distortions does not necessarily lead to Pareto-optimality since we must take into account the welfare and efficiency loss due to distortions that persist after liberalisation.

In the case of the water industry, research tends to focus on performance comparison between public and private sector water companies instead of the link between performance and liberalisation per se. This is mainly due to the nature of the industry, which maintains its 'natural monopoly' characteristic at a local/regional level despite privatisation. When looked at from this perspective, the evidence suggests that there is no systematic difference in performance (Hall and Lobina, 2005).

For example, International Monetary Fund (IMF, 2004) reports that public-private partnerships (PPPs) are not necessarily more efficient in water than public investment and government supply of services. While there is an extensive literature on this subject, the theory is ambiguous and the empirical evidence is mixed. Willner and Parker (2002) survey a large number of studies on the question of private versus public efficiency and report that there is no consistent conclusion to be drawn. While in some cases there is greater private sector efficiency, in some others there is greater public sector efficiency or no difference. They conclude as follows: "it appears ... that a change of ownership from public to private is not necessarily a cure for an under-performing organisation". This conclusion is supported by Estache et al. (2005) who conclude that "there is no statistically significant difference between the efficiency performance of public and private operators in this sector." Finally, Wallsten and Kosec (2005) report that, in the USA, there is little difference between private and public sectors in terms of regulatory compliance and household expenditure on water, if one takes account of water source, location fixed effects, country income, urbanization, and year.

Overall, network industry liberalisation (including privatisation and sector specific regulation) appears to have ambiguous effects on performance. This conclusion is supported by more recent data, which show that regulation could be more efficient when implementing an industrial policy rather than when implementing (only) a pro-competitive regulation (see Flacher

and Jennequin, 2008 for an illustration with the telecommunications sector). In addition, *ex ante* and *ex post* indicators also suggest that the emerging European regulatory regime is less than optimal. As a result, one is justified to suggest that network industry liberalisation has been oversold – in terms of its effects on competition as intermediate target and on efficiency as the ultimate target.

8.4 Liberalisation, regulation and investment: The case of telecommunications and electricity

In the European telecommunications sector, competition and *ex ante* regulation may be considered as responsible for the emergence of new services (such as Internet and mobile telephony services) and for the decrease in prices. However, it is equally plausible to attribute this sector-specific performance also to major changes that happened before liberalisation. The techniques and standards for mobile telephony have mainly been developed before 1998; and the Internet and the main associated tools had been invented by the US army and developed by the public sector. Liberalisation-induced competition may well have accelerated the adoption of these innovations and the fall in prices that followed. However, there is also the question as to whether liberalisation and induced competition (which is usually of imperfect nature) can instigate investment and innovation.

To answer this question, we propose to distinguish between two types of innovation: incremental innovation and breakthroughs. Incremental innovation can be defined as innovation aiming at *horizontal differentiation* that allows firms to provide similar products in terms of quality and functionality, which however appear as different for the various types of consumers. This type of innovation is not due to qualitative rupture but to commercial investments. Incremental innovation can usually be considered as short-term oriented and it is functional mainly in increasing the ability of the firm to maintain market shares and mark-ups (i.e., the associated externalities are quite low or non-existent). Conversely, radical innovation (or breakthroughs) induces vertical differentiation, which is often associated with investment in new infrastructures and development of radically new services. Radical innovation is long-term oriented and usually benefits the whole sector (that is, it is associated with positive externalities).

These two types of innovations may be complementary, but firms tend to be biased in favour of incremental rather than radical innovation for two reasons. First, radical innovation carries higher risks and it is associated with positive externalities that eventually benefit competitors. Second, information economics suggests that the cost of information induces firms to concentrate on incremental innovation, which is based on more familiar 'signals' that can be processed with existing 'information processing' channels in the firm (Arrow, 1984a and 1984b). This is why firms may be

efficient in innovations involving modifications to existing technology, but they would remain inefficient with respect to innovations constituting technological breakthroughs.

The relevance of these considerations is affirmed by Jorde, Sidak and Teece (2000), who point out that *ex ante* regulation of network industries (through mandatory unbundling based on cost-oriented and non-discriminatory principles of access) reduces incumbents' investment both in maintaining and improving the networks and in adopting new technologies. This is mainly due to the adverse effect of regulation on the option value of investment. At the same time, regulation delays competitor's investment since the latter is able to take advantage of incumbent's investment without taking risks. This perspective has been further developed in the theory of real options. Pyndick (2003), for example, points out the irreversibility of large investment in the telecommunications sector and the uncertainty surrounding the returns on investment. In this perspective, mandatory unbundling can be considered as a transfer of benefits from the investor to its competitors without the corresponding transfer of risks.

Another issue that complicates the investment performance in the telecommunications sector is the type of regulation. For example, Averch and Johnson (1962) have shown that the rate of return regulation can lead to overinvestment while the work of Gilbert and Newberry (1988) lead to an opposite conclusion. The debate concerning price regulation seems to be dominated by the risk of underinvestment in both incremental and radical innovation.

When attention is focused on access regulation, Foros (2004) and Kotakorpi (2006) demonstrate that an incumbent active in both infrastructure and service delivery tends to underinvest in infrastructure investment and maintenance (incremental innovation) when faced with a competitor active in the services layer only. This is because access regulation forces the integrated operator to share the benefits of investment with competitors. Concerning radical investment, the model by Bourreau and Dogan (2005) has shown that low unbundling rates can lead to underinvestment in new infrastructures since competitors prefer to rent the infrastructure rather than building a new and innovating one. Flacher and Jennequin (2007) have also pointed out that the short- and long-term effects of radical investment on consumers' welfare leads to underinvestment if the regulator is not able to forecast and integrate these long-term effects in its decisions, which is reasonably the case. Other models, such as the one by Grimm and Zoettl (2006) have similar conclusions concerning the risk generated by price regulation for investment and thus innovation.

It is worth indicating here that these theoretical warnings are corroborated by the few empirical analyses that exist and by raw data. For example, between 2001 and 2004, the investment of French operators fell by more than 48 per cent according to ARCEP data. Even if the level of investment

has grown after 2004 and slowed down again in 2007, and even if investment is cyclical, these evolutions cannot be explained only by the burst of the speculative bubble, cyclical investments or technical progress. The share of invested revenue also fell dramatically: from 21.2 per cent in 1995 to 11.3 per cent in 2003 in France according to ITU's data. The situation is similar in other countries (13.5 per cent in 1995 and 6 per cent in 2003 in the USA; 26 per cent in 1995 and 13 per cent in 2003 in the United Kingdom).

Under liberalisation and *ex ante* regulation, there are also similar problems with respect to R&D expenditures. According to IDATE data, the incumbents' share of R&D in the revenue has fallen from 3.7 per cent in 1995 to 1.3 per cent in 2004 for France Télécom, and from 2.4 per cent to 1.4 per cent for British Telecom. And this fall is not necessarily compensated by the growth of R&D in the equipments industry. Moreover, according to Pouillot and Puyssochet (2002) or to Calderini and Garrone (2001, 2002), competition and regulation could have structurally modified the R&D activity, favouring short-term and high application-oriented projects rather than long-term and basic research. This substitution between incremental and radical investments in R&D can have immediate positive effects, offering a large range of products and lower prices, but it could also have negative effects on the dynamics of telecommunications development.

Discussions on the investment effect of liberalisation in the electricity sector revolve around the gap between production and utilisation capacities. According to Maloney (2001), the utilisation rate of the production capacity in the US electricity sector should increase from 50 per cent (with monopoly) to 70–80 per cent (with competition). This example suggests that monopoly tends to overinvest in production capacities – as foreseen by Averch and Johnson (1962). However, the increased utilisation of production capacities under competition could be interpreted in three ways. First, it can be interpreted as 'rationalisation' of the investment, induced by competition. The second interpretation is that demand auto-regulation (the check on demand in peak periods via increasing prices) allows firms to limit the needed rate of capacity reserve and thus to reduce costs. The third interpretation is that liberalisation could be seen to be leading to underinvestment and dangerous strategic behaviour.

As Esnault (2003) points out, the short term is indeed characterised by the reduction of capacity reserves, defined as the difference between total capacity and maximum demand at peak periods. This reduces costs but increases the risks to supply failures as the price-elasticity of electricity consumption is quite low. As an illustration, the rate of capacity reserve usually considered as reasonable is between 15 per cent and 25 per cent – depending on the quality of the transport and distribution networks and on the possibility of importing or exporting electricity. In 1999, this rate seems very high in countries that did not start the liberalisation process: around 30 per cent in France, Germany, Greece, and Netherlands; and in excess of 40 per cent

in Italy, Denmark, Spain and Portugal. It is much lower in already liberalised markets – around 20 per cent in Finland, Sweden and United-Kingdom and 16 per cent in the USA.

However, even though rationalization could be viewed in a positive light in terms of investment efficiency, consequences concerning risks, price volatility and possible underinvestment are far from negligible. Ciccone (2001), for instance, shows that liberalisation in 24 states of the USA led to price increase during the 1990s in particular because capacity investment (+1.8 per cent per year) was not high enough to cover the increasing demand (2–3 per cent per year). Consequently, the overall rate of capacity reserves in the US went down from 25–30 per cent between 1978 and 1992 to less than 15 per cent at the beginning of the 2000s.

These figures and trends indicate that liberalisation could raise an important problem of underinvestment. The problem may or may not be severe depending on whether operators react to price increases induced by increased demand for electricity; or whether they would prefer to wait for 'verifiable' scarcity before undertaking investment. It is not possible to determine *a priori* which type of reaction is likely to dominate. This is the case even if the regulator has explicit powers to monitor the investment performance of the sector. The regulator, due to imperfect information or outright capture, may not be able to distinguish between a reaction to price signals and one informed by the wait to verify scarcity. Therefore, there are no binding constraints that induce the operators (whether incumbents or new entrants) to base their investment decisions on price signals instead of verified scarcity.

There is an additional factor that may work against timely investment reactions to price signals: long-term investment in major power stations may be discouraged because of high fixed costs and uncertainty about future prices, as well as uncertainty concerning technological developments and policy orientations such as changes in environmental policy. Therefore, profitability requirements and uncertainty may induce short-term investment into small plants – unless the regulator or the government provides some types of direct or indirect subsidies.

Indeed, as Esnault (2003) demonstrates, two possible investment scenarios can be anticipated. If supply shortage is verified to exist over a large geographical area, investment is not very risky and the location of the activity would depend on the access regulation policy. The main problem here is that the decision to invest may be taken too late. If the problem is due to congestions that induce temporary but regular peaks of prices and volatility on spot markets, the strategy can be one of developing the interconnection infrastructures and/or the one of investing into small, quickly built and low-efficiency power stations that only work during price peaks. Such investment is necessarily small in magnitude and often aims at speculating on possible supply scarcity rather than guaranteeing secure electricity

supply. One obvious consequence of these dynamics is the risk concerning security of supply and also the risk of increased price levels as well as volatility in the medium or long term after liberalisation.

The issues highlighted above imply that there are significant limits to the investment efficiency of the liberalisation of the electricity sector. It is necessary to describe the investment problem in the electricity sector as a general problem that is encountered in both liberalised and non-liberalised regimes with different implications. Under liberalisation, profit maximisation concerns induce firms to reduce risk taking, to invest less than optimal and eventually to valorise over-scarcity. Under monopoly (especially public ones), however, there is a tendency to invest more than optimal. Therefore, it is quite misleading to present the liberalisation alternative as a solution to the investment problem in the electricity sector. The same applies to public monopolies too. However, if one is to choose between two *imperfect* alternatives, it can make better 'economics' to choose the relatively excessive levels of investment observed under public ownership, which can be considered as an insurance premium paid to avoid the risks associated with liberalised/private provision. This is why Esnault (2003, p. 19) is led to conclude that the state may be a better player for investment in the electricity sector, "which totally contradicts the theoretical basis of competition-oriented regulation."

8.5 Conclusion

The theoretical arguments and empirical findings are too varied and contradictory to make the case in favour of liberalisation as a superior regime for ensuring efficiency and welfare gains in European network industries. The evidence presented above indicates that market-opening reforms in European network industries are essentially a movement from one second best to another. Liberalisation has replaced the natural monopoly under public ownership with oligopolistic markets where ownership could be either public or private. Therefore: (1) it is difficult to establish that market-opening reforms have been conducive to a general decline in prices, with the notable exception of telecommunications; and (2) it is equally difficult to conclude that the resulting oligopolistic competition is necessarily more efficient than the previous regime.

From the theoretical perspective, the theory of second best demonstrates that liberalisation policies can induce adverse effects due to persisting distortions in the sector or in the rest of the economy. In addition, the theory of imperfect competition fails to provide a unified framework that would offer clear perspective for the efficient 'competition-oriented' liberalisation and regulation. Although in the telecommunications sector liberalisation has led declining fixed costs and rapid innovation concerning a wide range of services, this is not necessarily the case in other network industries. Electricity and gas, for instance, are raising major problems (in particular

investment, geopolitical, environmental and safety ones) that the market is unable to resolve without significant public intervention. Under these conditions, it is possible to conclude that the argument in favour of liberalisation as a welfare- and efficiency-enhancing policy choice has been grossly oversold.

From the empirical perspective, the findings tend to corroborate the doubts raised by the second-best theory. Although it is feasible to argue that market-opening reforms are steps in the right direction and that they should reduce the inefficiencies associated with natural monopolies, the overall result in terms of efficiency and welfare is not necessarily better. Simulation studies on the effects of liberalisation reforms and deregulation may well yield positive results, but these results represents merely benchmark results that overlook the 'reality gap' between the assumed model of perfect competition and the messy environment of imperfect competition that persist after liberalisation. Therefore, it is not surprising to observe that a large number of studies on the energy, rail transport and water liberalisation tend to come up with negative sector-specific results concerning the welfare and efficiency implications of liberalisation.

From a political economy perspective, the deficiencies of the market-opening reforms in European network industries will continue to haunt the process of European integration. Unlike the single market programme, the legitimacy of market-opening reforms will remain contested within member states and between the various stakeholders. This is because these reforms, unlike the removal of non-tariff barriers through the single market, do not constitute a move to a purely theoretical first best. As a move within the second-best environment, market-opening reforms cannot guarantee the achievement of Pareto-optimality. Overall, social welfare may increase, decrease or remain the same. Moreover, welfare improvements may not be optimal in distributive efficiency sense. This will continue to foster scepticism among stakeholders who are likely to lose and will increase the scope for national governments to cobble up sub-optimal liberalisation and regulatory packages that can be presented as indicators of 'success' in defending national interests. Therefore, network industry liberalisation is highly likely to be a protracted process, characterised by piecemeal, reactive policy-making and high incidence of political compromises that have very little to do with the ultimate aim of improving efficiency.

References

Arrow, K. J. (1984a) "Information and Economic Behaviour" in Arrow, K. J. (ed.), The Economics of Information (Cambridge, MA: The Belknap Press of Harvard University Press), pp. 136–152.

Arrow, K. J. (1984b) "On the Agenda of Organisations" in Arrow, K. J. (ed.), The Economics of Information (Cambridge, MA: The Belknap Press of Harvard University Press), pp. 167–184.

Averch, H. and Johnson, L. (1962) "Behaviour of the Firm under Regulatory Constraint", American Economic Review, Vol. 52, December, pp. 1052–1069.
Baldwin, R., Forslid, R., Martin, P., Ottaviano, G. and Robert-Nicoud, F. (2003) Economic Geography and Public Policy (Princeton, NJ: Princeton University Press).
Baumol, W. J. (1965) "Informal Judgement, Rigorous Theory and Public Policy", Southern Economic Journal, Vol. 32, No. 1, pp. 137–146.
Borenstein, S., Bushnell, J. B. and Wolak, F. A. (2002) "Measuring Market Inefficiencies in California's Restructured Wholesale Electricity market", American Economic Review, Vol. 92, No. 5, pp. 1376–1405.
Bortolotti, B., D'Souza, J., Fantini, M. and Megginson, W. (2002) "Privatization and the Sources of Performance Improvement in the Global Telecommunications Industry", Telecommunications Policy, Vol. 26, pp. 243–268.
Bourreau, M. and Doğan, P. (2005) "Unbundling the Local Loop", European Economic Review, Vol. 49, pp. 173–199.
Bouttès, Jean-Paul (2005) "Sécurité d'approvisionnement et investissement dans l'électricité", Revue de l'Energie, Vol. 566, pp. 229–237.
Boylaud, O. and Nicoletti, G. (2001) "Secteur des télécommunications: réglementation, structure de marché et performance", Revue Economique de l'OCDE, Vol. 32 (Paris), pp. 112–158.
Buehler, S. (2005) "The Promise and Pitfalls of Restructuring Network Industries", German Economic Review, Vol. 6, No. 2, pp. 205–228.
Bushnell, J. B. and Mansur, E. T. (2005) "Consumption under Noisy Price Signals: A Study of Electricity Retail Rate Deregulation in San Diego", Journal of Industrial Economics, Vol. 53, No. 4, pp. 493–513.
Calderini, M. and Garrone, P. (2001) "Liberalisation, Industry Turmoil and the Balance of R&D Activities", Information Economics and Policy, Vol. 105, March, pp. 333–344.
Calderini, M. and Garrone, P. (2002) "The Changing Nature of R&D Activities in Telecommunications", Communications & Strategies, Vol. 48, 4th quarter, pp. 53–72.
Chunrong, A. and Sappington, D. (2002) "The Impact of State Incentive Regulation on the U.S. Telecommunications Industry", Journal of Regulatory Economics, Vol. 22, No. 2, pp. 133–160.
Ciccone, John (2001) "Time to build", Electric Perspectives, Vol. 26, No. 1, pp. 14–25.
Copenhagen Economics (2005) Market Opening in Network Industries: Parts I and II (Report No. 6201 for DG Internal Market, September, Copenhagen), http://www.copenhageneconomics.com/publications (accessed February 2007).
Esnault, B. (2003) "Nouveaux marchés de l'électricité et stratégies d'investissement", Economies et Sociétés, série Economie de l'Energie, EN No. 9, February–March, pp. 433–450.
Esnault, B. (2006) "La régulation des risques énergétiques, une perspective socio-économique", Economies et Sociétés, série Economie de l'Energie, EN No. 10, October/November, pp. 1359–1392.
Estache, A. and Martimort, D. (1999) "Politics, Transaction Costs and the Design of Regulatory Institutions", World Bank Policy Research Working Papers, No. 2073, http://www-wds.worldbank.org/external/default/WDSContentServer/IW3P/IB/1999/04/20/000094946_99032604581622/Rendered/PDF/multi_page.pdf (accessed 30 April 2007).
Estache, A., Perelman, S. and Trujillo, L. (2005) "Infrastructure Performance and Reform in Developing and Transition Economies: Evidence from a Survey of Productivity Measures", World Bank Policy Research Working Paper, No. 3514, February.

European Regulators Group for Electricity and Gas (ERGEG) (2006) Assessment of the Development of the European Energy Market (Ref: E06-MOR-02-03, December), http://www.ceer-eu.org/portal/page/portal/ERGEG_HOME/ERGEG (accessed 20 March 2007).

EU Commission, DG Competition (2007) Report on Energy Sector Inquiry (SEC (2006) 1724, 10 January, Brussels).

Flacher, D. and Jennequin, H. (2007) Réguler le secteur des télécommunications? Enjeux et perspectives (Paris: Economica, March), p. 318.

Flacher, D. and Jennequin, H. (2008) "Is Telecommunications Regulation Efficient? An International Perspective", Telecommunications Policy, Vol. 32, No. 5, June, pp. 364–377.

Foros, Ø. (2004) "Strategic Investments with Spillovers, Vertical Integration and Foreclosure in the Broadband Access Market", International Journal of Industrial Organization, Vol. 22, pp. 1–24.

Fujita, M., Krugman, P. and Venables, A. (1999) The Spatial Economy. Cities, Regions and International Trade (Cambridge, MA: MIT Press).

Gilbert, R. and Newberry, D. (1988) "Regulation Games", Working Paper, No. 8879 (Berkeley, CA: Department of Economics, University of California).

Grimm, V. and Zoettl, G. (2006) Capacity Choice under Uncertainty: The Impact of Market Structure (CORE Discussion paper).

Hall, D. and Lobina, E. (2005) "The Relative Efficiency of Public and Private Sector Water", PSIRU (University of Greenwich: Business School, September).

IMF (2004) "Public-Private Partnerships", Policy Paper, 12 March 2004, http://www.imf.org/external/np/fad/2004/pifp/eng/031204.htm

Jennequin, H. (2005) "La localisation des activités tertiaires: un enjeu économique majeur", Thèse de Doctorat en Sciences Economiques (Université Paris XIII, December).

Jorde, T. M., Sidak, J. G. and Teece, D. J. (2000) "Innovation, Investment and Unbundling", Yale Journal on Regulation, Vol. 17, pp. 1–37.

Kotakorpi, K. (2006) "Access Price Regulation, Investment and Entry in Telecommunications", International Journal of Industrial Organization, Vol. 24, No. 5, September, pp. 1013–1020.

Li, W. and Xu, L. (2002) "The Impact of Privatization and Competition in the Telecommunications Sector around the World", Darden Business School Working Paper, No. 02–13.

Lipsey, R. G. (2007) Reflections on the General Theory of Second Best at Its Golden Jubilee, http://www.sfu.ca/~rlipsey (accessed 18 April 2007).

Lipsey, R. G. and Lancaster, K. (1956) "The General Theory of Second Best", The Review of Economic Studies, Vol. 24, No. 1, pp. 11–32.

Maloney, M. T. (2001) "Economies and Diseconomies: Estimating Electricity Cost Functions", Review of Industrial Organization, Vol. 19, pp. 165–180.

Martin, P. and Rogers, C. A. (1995) "Industrial Location and Public Infrastructure", Journal of International Economics, Vol. 39, No. 3/4, pp. 335–351.

Mitra, A., Stoler, D. and Lin, T-C (2005) "Deregulation of the Electric Utility Industry: An Empirical Study", Public Finance and Management, Vol. 5, No. 3, pp. 439–453.

Moore, C. G. (1975) "Has Electricity Regulation Resulted in Higher Prices? An Econometric Evaluation Using a Calibrated Regulatory Input Variable", Economic Inquiry, Vol. 7, pp. 207–220.

OECD (2003) "Indicators for the Assessment of Telecommunications Competition", Working Party on Telecommunication and Information Services Policies, 1 March (Paris: OECD).

Pouillot, D. and Puissochet, A. (2002) "R&D Spending in ICT, Overall Evolution in the Major Industrial Countries, and Close-Up on Telecom Operators' New Organization", Communications & Strategies, Vol. 48, 4th quarter, pp. 33–48.
Pyndick, R. S. (2003) "Mandatory Unbundling and Irreversible Investment in Telecom Networks", Working Paper, No. 4452–03 (MIT Sloan, December).
Scherp, J. (2005) "Railway (de-)Regulation in EU Member States and the Future of European Rail", CESifo Dice Report 4/2005, http://ec.europa.eu/transport/rail/overview/articles_en.htm (accessed 16 April 2007).
Ugur, M. (2007a) Liberalisation of Network Industries in the European Union: Evidence on Market Integration and Performance (Paper submitted to European Union Studies Association (EUSA) 10th Biennial International Conference, Montreal, Canada, 17–19, May).
Ugur, M. (2007b) Regulatory Quality in EU Network Industries: Evidence on Telecommunications, Gas, Electricity and Rail Transport (Paper submitted to European Union Studies Association (EUSA) 10th Biennial International Conference, Montreal, Canada, 17–19, May).
Upadhyaya, K. P. and Raymond, J. E. (1994) What Can Regulators Regulate? The Case of Electricity Revisited (Auburn, AL: Department of Economics, Auburn University).
Upadhyaya, K. P. and Mixon Jr., F. G. (1995) "Regulatory Capture and the Price of Electricity: Evidence from Time Series Estimates", International Journal of Social Economics, Vol. 22, No. 1, pp. 16–23.
Uri, N. (2003) "The Effect of Incentive Regulation in Telecommunications in the United States", Quality and Quantity, Vol. 37, No. 2, pp. 169–191.
Wallsten, S. (2001) "An Econometric Analysis of Telecom Competition, Privatization, and Regulation in Africa and Latin America", Journal of Industrial Economics, Vol. 49, No. 1, March, pp. 1–48.
Wallsten, S. and Kosec, K. (2005) "Public or Private Drinking Water? The Effects of Ownership and Benchmark Competition on U.S. Water System: Regulatory Compliance and Household Water Expenditures", Working Paper 05–05, (March), http://www.aei-brookings.com/publications/abstract.php?pid=919
Willner, J. and Parker, D. (2002) The Relative Performance of Public and Private Enterprise under Conditions of Active and Passive Ownership (Centre on Regulation and Competition, Paper No. 22, October), http://www.competition-regulation.org.uk/wpdl149/wp22.pdf

9
Privatisation and Marketisation of Health Care Systems in Europe

Christine André and Christoph Hermann

9.1 Introduction

The financing and provision of health care in Europe has always involved a variety of institutions and actors, some of whom were public and others were private. The situation is all the more complex as private health services can either be provided for-profit or not-for-profit. However, what makes health care a traditional public service and what distinguishes Western Europe from the United States are the wide compulsory coverage by health systems, the crucial role of the state in planning and overseeing the system and the subordinated role of private for-profit insurers and health care suppliers. After having examined the main characteristics of the evolution of health care systems in Europe, we will look at the different ways privatisation and marketisation are implemented and at the role of the European Union.

9.2 The main characteristics of the evolution of health care systems in Europe

9.2.1 The specificities of the health care sector

Several specificities of the health care sector make it particularly complex as for its functioning. Only some part of health care can be, strictly speaking, identified with a public good, for example being non-excludable and non-rival: care concerning contagious diseases. The other types of care do not present characteristics of a public good, nevertheless several other reasons justify the intervention of the state in this domain: health is a major factor in the productivity of labour; too high health inequalities could put into question the social cohesion; economies of scale are important in the domain of prevention of contagious diseases; the health sector does not fulfil the underlying hypotheses of a pure and perfect market (there is information asymmetry for instance); a moral standpoint must also be taken into account, as everybody must receive high-quality treatment regardless of his or her income. In summary, health care cannot function according to pure

private market principles and the state resumes a crucial role in ensuring the access to health services, guaranteeing the quality of health services, and planning and managing the health care sector.

9.2.2 The role of the state and the basic health care models

In the nineteenth century, when the foundations of health systems were laid down in the Western Europe, firms were reluctant to invest in their own health care system because workers were mobile and the firms could not make cost-effective such an investment (Delorme and André, 1983). Therefore, it was the state that set up the first elements of health care systems, giving them the basis of their actual characteristics under two basic forms. The Bismarckian model[1] was mainly based on a public social health insurance for wage-earners which was financed by mandatory contributions mainly paid into public funds; today the coverage is often extended to almost all the population. In the Beveridgian model, health care costs are paid from taxes and health care services are provided by a national health service covering the citizens (often defined by referring to a criterion of residence), making it an integrated public financing and delivery model. The Bismarckian model prevails in continental Europe while the UK, the Nordic and the southern countries have chosen the tax-based solution for financing health care. In both systems there is some form of redistribution due to the mode of financing.

In Central and Eastern Europe, on the other hand, health care systems were of the Semashko type, that is universal, centralised and funded by the state budget until the structural reforms of the 1990s.

Since the Second World War, the Western European states have continuously expanded their responsibility for the health sector through a variety of measures, including the planning of supply, the funding of research and innovation, the regulation and training of medical professions, the establishment and control of medical standards and, not least, the extension of health care funding (Maarse, 2004; Moran, 1999). So the state plays a major role both in the financing and in the provision of health care. However, the role is not the same in all dimensions and countries: In the Beveridgian systems the hospital sector is essentially public (Maarse, 2006), while in the Bismarckian systems there is traditionally a large private but not-for-profit sector.

9.2.3 Drivers of health care restructuring

Several elements contributed to the restructuring of health systems: the high increase of health spending clashed with a fiscal constraint at the end of the 1980s, in a context where financial capital, in search of profitable assets, had become a major player.

The growth of health care spending was continuously sustained during the last twenty years though not steadily. Furthermore, the rise of total health spending was noticeably different depending on countries. If we

group the European countries according to the welfare state typology in five clusters, each one presents its own specificities when looking both at health spending and financing (Table 9.1).

Between 1980 and 2005, among the West European countries, the growth of health spending was particularly high in the southern countries due to a catch-up effect, with an increase up to about 5 per cent of Gross Domestic Product (GDP) in Portugal and in Greece. The continental European countries come in the second rank for the importance of the increase of spending. As for the Anglo-Saxon countries, the change is limited in Ireland and even negative in the United Kingdom. Health spending remains relatively stable in the Nordic countries with the exception of Finland where the transformation of the health system was more important. As for the new member states of the Central and East European Countries (CEE), the ratio of health care spending to GDP is still significantly lower than in the other countries, though the political changes and the economic shocks in the early 1990s led to an important increase.

A large variety of reasons combine for explaining such a rise of health spending. Some are associated with supply. Technological innovations, the use of increasingly expensive equipment and medication, the need for new skills and qualifications, as well as a growing awareness for patient rights, all played a role in the increase of health spending in the past three decades. In addition, the power of pharmaceutical and medical equipment industries also plays a role in the swift rise of the prices of their products and in the swift replacement of existing products by new ones. On the other hand, the extension of the coverage of population, dissatisfaction of patients towards the public health system in case of waiting lists, and enlarged information of patients about new care methods led to a growing demand.

When the growth of GDP slowed down during the 1980s, the increase of tax and of social contributions was curbed as their base was hampered by unemployment, new atypical jobs, and stagnation of wages. Neoliberal ideas gained also in importance with several neoconservative parties coming to power. Then, economic austerity became one of the major goals of the European Union, especially at the turn of the 1980s to 1990s. This is particularly true for the member states that have joined the Growth and Stability Pact and that had to apply the Maastricht criteria and the limitation of the budget deficit to a maximum of 3 per cent of GDP. Confronted with the rise of public expenditure, most of the governments developed new measures for controlling public health spending. Some countries, in particular the southern ones, which had to rebuild a new health care system, nevertheless let this spending increase.

Econometric analysis confirms that the financing constraint played a major role for the turn, at the beginning of the 1990s, in the evolution of health spending. Moreover, this led to some convergence of health spending in EU-14[2] (André, 2008).

Table 9.1 Health care systems: Spending and financing

	Continental					Nordic			Anglo-Sax.		Southern				CEE			
	Au	**Be**	**Fr**	**Ge***	**Nl**	**Dk**	**Fi**	**Sw**	**Ir**	**UK**	**Gr**	**It**	**Po**	**Sp**	**Cz**	**Hu**	**Pl**	**Sl**
	Total health spending : in % of GDP																	
1980	7.5	6.3	7.0	8.4	7.5	8.9	6.3	9.0	8.3	5.6	5.1	7.7b	5.3	5.3	4.7b	n/a	4.8b	n/a
2005	10.2	10.3e	11.1	10.7	8.0a	9.1e	7.5	9.1	7.5	8.3d	10.1	8.9	10.2e	8.2e	7.2	6.9a	6.2e	7.1
	Public health spending: in % of total health spending																	
1980	68.8	n/a	80.1	78.8	69.4	87.8	79	92.5	81.6	89.4	55.6	79.5b	64.3	79.9	96.8	n/a	91.7b	n/a
2005	75.7	72.3e	79.8	76.9	63.1a	84.1e	77.8	84.6	78	87.1d	42.8	76.6	72.7e	71.4e	88.6	70.7a	69.3e	74.4
	Structure of the financing of health care systems: in % of total financing																	
	General government																	
1980	n/a	n/a	4.3	11.7	5.4	87.8	66.6	92.5	70.9b	89.0	n/a	79.2b	n/a	n/a	n/a	n/a	91.7b	n/a
2005	29.7	4.2e	4.9	9.5	3.9a	84.1e	61.1	84.6	77.4	80.9a	n/a	76.4	71.9	66.5e	8.7	11.4a	11.4e	9.2
	Social security schemes																	
1980	n/a	n/a	75.8	67.0	64.0	0	12.5	0	0.8b	0	n/a	0.3a	n/a	n/a	n/a	n/a	n/a	n/a
2005	46	63.3	74.9	67.4	59.2a	0	16.6	n/a	0.5	n/a	n/a	0.1	0.8e	4.9e	79.9	59.3a	57.9e	65.2
	Out-of-pocket payments																	
1980	n/a	n/a	12.8	10.3	n/a	11.4	18.4	n/a	16.5b	8.6	n/a	17.1b	n/a	n/a	2.6b	n/a	8.3b	n/a
2005	16.4	21.2	6.9	13.1	9a	14.3e	17.8	n/a	13.4	n/a	n/a	20.3	22.3e	22.4e	10.9	26.3a	26.1e	22.6
	Private insurance and all other private funds																	
1980	7.6	n/a	5.7	11	n/a	n/a	2.6	n/a	11.8b	1.3	n/a	3.4b	0.8b	3.2	n/a	n/a	n/a	n/a
2005	7.9	6.5	13.5	10	23a	n/a	4.5	n/a	8.6	n/a	n/a	3.1	5.1	6.2e	0.5	3a	4.6e	3

Abbreviations: Au: Austria, Be: Belgium, Fr: France, Ge: Germany, Nl: Netherlands, Dk: Denmark, Fi: Finland, Sw: Sweden, Ir: Ireland, UK: United Kingdom, Gr: Greece, It: Italy, Po: Portugal, Sp: Spain, Cz: Czech Republic, Hu: Hungary, Pl: Poland, Sl: Slovak Republic.
a: 2000; b: 1990; e: estimates; d: differences in methodology; na: not available. *West Germany in 1980.
Sources: OECD Health Data (2007) and WHO data

Apart from the fiscal constraint, a second major driver of the restructuring of health systems was associated with the growing profits expected from the health sector by multinational health companies and pharmaceutical and medical equipment firms, in a context where the financial globalisation gave rise to a huge amount of financial assets waiting to be invested profitably. What makes the health care sector particularly interesting for private investors is that health business is non-cyclical and comparatively safe (Lethbridge, 2005). The increasing importance of health care as a profitable sector for investments can also be seen in the fact that it became a prominent issue in World Trade Organisation (WTO) talks about a General Agreement on Trade and Services (Atun, 2007; Sexton, 2003).

9.3 Forms of privatisation, competition and marketisation

The main instrument for controlling public health spending has been the development of different forms of privatisation and of marketisation. Indeed, privatisation reveals to be a very blurred concept. At first, 'private' refers to ownership. But 'private' can be used for a wide range of dimensions and 'privatisation' can be associated with different processes. A major difference must be kept in mind when studying the health sector as, here, not-for-profit private organisations are often more developed than for-profit private ones and as these two kinds of organisation do not aim at the same objectives. Moreover, marketisation was also widely developed through the introduction of internal markets and of new forms of organisation, management and financing, frequently referred to as 'new public management'. Though developing market mechanisms within public organisations is not privatising, nevertheless it can be considered as a first step towards privatisation as this is done with several objectives associated with privatisation, like controlling spending and improving efficiency, even if the ultimate aim of making profits is not present. Indeed, though some health organisations can be viewed as 'purely public' or 'purely private', a lot of health organisations can rather be associated with some complex mix of public and private elements. For instance public financing can finance the private sector, private financing can finance the public sector, contracts can be signed between public authorities or public hospitals and private providers, private practice can be authorized in public hospitals, and so on. Moreover, the state can decide to make compulsory some health insurance but the organisations which supply the corresponding benefits can be private.

A number of arguments have been given for extending the role of private actors and of several private business principles in the health sector. The most usual argument consists in assuming higher efficiency, effectiveness and control of costs in private organisations, and better quality of care (Maarse, 2006, p. 1003). Much of transformation also took place under the

pretext of enabling and increasing the choice, which was considered as a positive point per se for patients and as a way for increasing competition and then efficiency.

All these transformations resulted in an inflection in the evolution of public health financing at the beginning of the 1990s. As a result the relative share of public health expenditure in total spending has decreased between 1980 and 2005 with the exceptions of Austria and Portugal (Table 9.1). Among countries with the strongest reductions of this ratio are Greece, Spain and the new member states in CEE, all countries where the health system was deeply reorganized (André, 2008). In 2005, this share varies between a minimum of 42.8 per cent in Greece and a maximum of 84–89 per cent reached in Denmark, Sweden, the UK and the Czech Republic. The relative decrease of public spending went hand in hand with an increasing importance of private health insurance companies and/or of out-of-pocket payments in the financing of health care costs (Table 9.1). The structure of the financing is still very different depending on countries.

9.3.1 Private health insurance

The percentage of private health insurances as proportion of total health care spending varies in 2005, for countries with disposable information, between 3.1 per cent in Italy and 23 per cent in Netherlands (Table 9.1). The share of private health insurances depends on the type of health system and the coverage of the public system, and on the type of coverage that private insurance ensures.

- Substitutive (for people excluded from the public basic scheme, mainly in the Netherlands, Germany, Spain; such a system is not present in countries with a national health service), and duplicate (when some groups are offered the choice between a public and a private insurance for the basic scheme).
- Complementary (for the part of costs not covered by public health insurance): it is particularly large in France with 94 per cent of the population in 2000 and in the Netherlands with more than 60 per cent (Mossialos and Thomson, 2004), and it is much less important in the southern countries (11.4 per cent in Spain).
- Supplementary (for care not covered by public health insurance, in particular for having an increased choice): it is more developed in Portugal with 12 per cent of the population, the UK with 11.5 per cent and Greece with 10 per cent (ibid.).

The share of private insurance is more important in the Bismarckian systems represented by the continental countries and particularly in the Netherlands. The growing importance of complementary health insurance in Europe is widely due to a common trend: the delisting or the lowering

of the reimbursement of treatments and medication that are funded by public health insurance. Private insurance is most often voluntary but it may be compulsory in countries where it can propose a primary source of coverage.

Out-of-pocket payments include not only direct payments and co-payments but also informal payments for preferential treatment (considered as 'tokens of gratitude' for instance in Poland) (Jemiai et al., 2004; Kozek, 2006, p. 1). Their ratio to total health spending is rather large and varies in 2005, for the Western countries for which data are disposable, between 6.9 per cent in France and 22.4 per cent in Spain. France seems to be an exception as this ratio has noticeably decreased contrary to the most general trend of stability or increase, but this is due to the fact that it is the complementary insurance that paid for the delisting.

All these changes at the macro-level result from changes in the organisation and in the functioning of the different components of the health care sector.

9.3.2 Privatisation of public hospitals

The most radical forms of privatisation in health care provision are the sale of public hospitals to private investors and the creation of new private hospitals. Germany stands out as the only country in Europe where the sale of public hospitals was carried out at a large scale and in a systematic way (Maarse, 2006, p. 996), so the proportion of private hospitals increased from 14.8 to 25.4 per cent between 1991 and 2004 and the share of public hospitals decreased from 46 to 36 per cent while the proportion of not-for-profit hospitals remained relatively stable (Schulten, 2007, pp. 37–39). The struggle for market shares has also led to series of mergers and acquisitions which have raised the attention of the German Federal Cartel Office. Moreover, while private hospitals in Germany were almost exclusively owned by German shareholders until recently, the extent of privatisation has increasingly attracted foreign investors. A number of other countries experimented with such a privatisation of public hospitals, including Sweden and Austria. Apart from the sale of public hospitals to private investors, several countries have also seen an increase in the number of newly built private hospitals. This is the case in the new member states of CEE where these private hospitals aim at privately insured or self-paying patients. This means that their market share is limited.

9.3.3 More choice for patients and competition

While in some countries patients, for a long time, have had the possibility to choose between different health insurance schemes, hospitals and practitioners, choice has been introduced more recently in other ones in order to stimulate competition between insurers and between health care providers, be they public or private. This last case concerns most notably the

Beveridge-type health systems such as the UK and Sweden, but, with respect to choosing health insurance, the Netherlands went the furthest by requiring their different public health insurance schemes to compete with other public and private insurers for clients (Maarse and Meulen, 2006). Actually, choice in health care systems can take many different forms as shown by (Thomson and Dixon, 2004): choice between public and private insurance (Germany, Austria, Portugal, Spain); choice of a public insurance fund (Belgium, Netherlands, Germany); choice of a general practitioner (most of the Western countries) but sometimes constraint on the choice of a specialist (France, Germany) (Ettelt et al., 2006); choice of a hospital (France, Germany; then Britain, Denmark, Sweden, Netherlands) and, when waiting lists are long, reimbursement of treatment abroad is sometimes authorized.

9.3.4 Marketisation

New modes of governance have also been implemented through different devices.

A first one consists in separating the funding and the provision of health care. As mentioned above, it is in the Netherlands that the split between insurers and care providers has been the earliest and the deepest. Two aims were pursued: competition between insurers on the one hand and competition between care providers on the other hand.

A second change of the governance results from the management autonomy given to public health services. On the one hand, this can be done with giving them financial autonomy at the same time. For instance, the introduction of National Health Service Trusts for public hospitals in Britain has been done with the purpose of giving them a financial autonomy and to increase competition. They have to secure their financing by winning contracts from commissioning bodies including District Health Authorities (DHAs) and general practitioners with fundholding status and with a budget to purchase treatment for their patients (Pond, 2007, p. 53). Furthermore, Foundation Trusts can also establish commercial arms or engage in existing commercial ventures, sell land and property, borrow money from private lenders and transfer staff to the private sector – which has a lasting impact on the organisation of public health care provision (ibid., p. 54; see also Pollock, 2003). On the other hand, the new management autonomy may be linked to budgetary constraints. For instance in the hospital sector, larger management autonomy has been given through global budgets or activity-based financing as diagnosis related groups (DRG). Such changes of mode of governance have also been implemented in the ambulatory sector in several countries including the UK with the creation of General Practitioners Fundholders (GPFH).

Another common reform across Europe is the development of internal markets or quasi-markets and of contracting out (Oliver and Mossialos, 2005, p. 16). Initially outsourcing only concerned secondary services such

as cleaning and catering. Then, more sophisticated services have been contracted out to the private sector including medical services such as laboratory and diagnostic services and even elective surgery information, and also management services such as accounting and even partly hospital planning. Again, it was Britain which pioneered the incorporation of market mechanisms into health service provision and, in 2000, the government promised greater involvement of the private sector through the 'Concordat'. The British Health Department estimates that the independent sector would provide 5.7 per cent of the National Health System (NHS) six million annual non-urgent procedures by 2007–2008 (Pond, 2007, pp. 56–57). Contracting out is now a common practice of many hospitals across Europe.

Public-private partnership (PPP) corresponds to long-term outsourcing contracts. PPP can take different forms such as the financing and the leasing of hospital buildings and of technical equipment, the provision of maintenance services, as well as the private management of public hospitals. The aim is to pass on risks to private investors and to better control the costs and the schedule. The main example of PPP is the Private Finance Initiative (PFI) in the UK (Pollock, 2003, pp. 52ff; Pond, 2007, pp. 57–58; Shaoul et al., 2008). The role of private partners in the PFI goes beyond allocating the financial resources and includes the design and construction of hospital buildings and even, in some cases, the operation of some of associated services such as catering, cleaning and security. Hence, the PFI involves a consortium of several companies typically including a bank or finance house, a construction company and a facilities management firm. Once the facility is up and running, the PFI consortium charges the relevant public authority an annual fee during the 25 to 30 years lifetime of the project. Since 1997, nearly all NHS hospitals have been financed under the PFI. There are strong doubts about the actual transfer of risks from the public sector to the private one given the long duration of the corresponding contracts.

More generally, all the previous forms of transformation took place in all the considered countries with different intensities (André, 2008) and have altered the way health care is delivered. It must also be noticed that some of the aims pursued through privatisation have also been pursued through decentralisation (Atun, 2007), an issue out of the scope of this chapter, which, in other respects, leads to some regions having their own policy as to privatisation.

9.4 The role of the European Union

Until now, the influence of the European Union (EU) on health care policies was limited. The European Treaty makes only reference to *public health* and obliges community action and national policies to "be directed towards improving public health, preventing human illness and diseases, and obviating sources of danger to human health" (Article 152, §1). The treaty,

furthermore, requires the Community to encourage member states cooperating in the field of public health and coordinating their respective efforts. The freedom of member states to design and administer their national health care services conflicts with one of the fundamental freedoms of the EU – the free movement of goods, services, persons and capital. This issue may be associated, in some extent, with the question of the nature of health care. Member states argue that health care is not an economic activity since the majority of providers do not intend to make a profit (Martinsen, 2005, p. 1041). Finally, health care was excluded from the scope of the Internal Market Service Directive adopted in December 2006. Notwithstanding earlier opposition by member states, the Commission circulated a draft for a Directive on Cross-Border Healthcare in the summer of 2007. The aim of the directive is to "ensure that there is a clear framework for cross-border healthcare within the EU" (European Commission, 2008).

The promotion of cross-border health care for non-emergency treatments, which until now affects a tiny minority of European patients, may not only threaten the ability of authorities to plan national health care systems, but also fuel differences among patients. Differences might increase on the one hand between those who are better off, having the possibility to get quicker and better treatment abroad, and those on the bottom of the income distribution scale, and, on the other hand, between richer and poorer countries, with richer countries sending their patients to poorer countries for cheap treatments while the population in the poorer countries cannot afford to pay for the same services.

In addition to promoting cross-border health care, the European Union has also put growing emphasis on streamlining national health care systems through the Open Method of Coordination (OMC) in order to spread best practices. Yet, because it is extremely difficult to define benchmarks and best practices in a complex and interdependent field such as national health services (Gerlinger and Urban, 2007, p. 138), the focus of health care reforms has first been put on fiscal stability.

9.5 The effects of privatisation, competition and marketisation

It is not possible to estimate the relative impact of the different forms of privatisation, competition and marketisation on health systems both because of lack of data and because of the entanglement of the effects of the different measures. A major problem, in particular, is not knowing the relative shares of private for-profit and private not-for-profit organizations whose functioning and regulation may be quite different. Nevertheless, the results of some studies give a strong reason to question the positive effects that were expected from such policies (Maarse, 2004).

The first effect of the reforms is a decrease of the share of the public part of health spending since 1980 except in Austria and in Portugal (Table 9.1).

Has such an inflection been accompanied by a rise of efficiency? What about equity and quality? More generally, what has been the impact of privatisation and of marketisation in health systems? In the remaining sections we try to give some answers to these questions.

9.5.1 Efficiency

Defining efficiency in the health care sector is a complex task going beyond the limits of this chapter. We will only refer here to empirical studies pointing out at the narrow point of view of costs reduction as the very few studies trying to adopt other criteria concern quite specific treatments.

Private health insurances are often expected to be more efficient than public insurance providers. However, several studies show that private insurance schemes have larger costs for administration and advertising than public ones. For instance, in continental countries, administrative costs are about 4–5 per cent of expenditure in public statutory regimes and vary between 10 per cent and 27 per cent of premium income in voluntary regimes (Mossialos and Thomson, 2004). This would be due, in particular, to transaction costs and to advertising costs. In addition, the potential effects of competition are often weakened through different mechanisms as sometimes private insurers develop a horizontal concentration. Moreover, if there is a strong competition, insurers contract with most of the providers. If insurers contracting with health care networks can lead to a reduction of costs, this depends mainly on the context and in particular on the pattern of competition (Bocognano et al., 1999, p. 185). In other respects, private insurers manage to transfer financial risk to doctors. Yet, regulating competition creates its own costs which may exceed the benefits (ibid.). In the same way, out-of-pocket-payments or cost-sharing likely exert some effects on the degree of utilisation of health services or of consumption of pharmaceuticals, but it is quite difficult to assess the ability of cost-sharing to discriminate between effective and ineffective health services (Jemiai et al., 2004).

As private insurance, private hospitals are also expected to work more efficiently than their public counterparts – especially since they must not only cover costs but in addition create profits. At first sight, comparisons between public hospitals and private clinics show that, at a global level, spending is smaller in the private sector. But this observation is largely due to the differences of their field of activity. Private clinics are rather specialised in treatments or in surgery which are standardised, following routines and necessitating few costly equipment. Complicated cases are generally not admitted in these clinics. Then, economies of scale can fully be exploited. On the contrary, public hospitals bear many constraints concerning a permanent opening with an emergency service, the obligation to give the same care to everybody, and the realisation of surgery with costly cases, multipathologies, and expensive equipment (Aballea et al., 2006). Moreover, public hospitals have also the functions of medical education and of research.

So, it is impossible to draw any general conclusion on the efficiency of public hospitals and of private clinics from a comparison of their expenditure.

When looking at public hospitals, has the introduction of new modes of financing improved their efficiency? For instance, the development of regulated national tariff prices (payments by result or PbR) for hospitals in the UK leads to results differing from those expected as they were applied to only a limited number of activities, causing distortion in provider behaviour, and they did not increase competition on quality. Examples from other countries also show that, when prices are fixed, quality is reduced to keep costs down. Moreover, such a system can lead to upcoding acts to more expensive procedures. Some care providers may also make some cream-skimming and choose the easiest cases within a particular category. In addition, the costs of implementing PbR have been greater than anticipated. Nevertheless, there are only few studies of the impact of the DRG and it is difficult to have strong conclusions but the advantages of such methods are not as evident as expected. In other respects, the association between public and private partners does not seem to be as efficient as waited. The case of the PFI, for instance, shows increasing evidence that the costs are higher than they were believed to be and that they are most certainly higher than if the same projects would have been financed by regular public loans (Shaoul et al., 2008). At last, as privatisation generally leads to a fragmentation of care services, this can reduce economies of scale. In other respects, private care providers would pay less attention to prevention, which could contribute increasing costs in the long term (Ietto-Gillies, 2008).

Last, what could be the effect of a generalised competition, aimed at by several reforms? Several examples show that, if competition could increase gains of productivity in the short term, with no necessarily lesser quality, the dynamics of markets would lead to larger and larger networks of care and to massive concentrations – especially in clinics and the pharmaceutical industry (Mougeot, 1999). So, competition would be progressively weakened and its positive effects lessened.

9.5.2 Quality

Again, the quality of care is a multidimensional concept which ought to include criteria of easy access to services; responsiveness to needs; reduction of waiting lists; adequate density of beds in hospitals, of doctors and of nurses; and so on (Ietto-Gillies, 2008). The existing assessments of the modification of quality of care are not sufficient to draw clear and firm conclusions about the effects of privatisation, competition and marketisation. Some studies show that private health insurance has only a minimal impact on the quality of care in most OECD countries (Colombo and Tapay, 2004) or that the deterioration of medical care does not seem to be a general consequence of managed care, but they also show that the results depend on the considered category of population, for instance in the USA

(Bocognano et al., 1999). The information of the patients plays also a role for this issue. Changes of the quality of care appear more clearly when looking at the in-patient sector. For public hospitals, considerable pressure has exerted for rationalising and reducing costs in all the countries, leading to a reduction of beds, frequent shortages of professionals and specially nurses, a shortening of the average length of stay, longer waiting lists, and so on. The quality of care may have also been modified by the changes of the mode of payment of doctors. The importance of the fee-for-service system was reduced as it tends to increase demand, and capitation and salary have replaced it. However, these last two systems also have some disadvantages as they can result in excessive referrals, over-prescribing, reduced access for sicker patients and less responsiveness to patients (Saltman and Figueras, 1996). Again, it would be necessary to have more detailed studies estimate the global effects of changes of modes of governance on quality of care, but these effects are surely far from being always positive.

9.5.3 Employment

Efficiency and quality are closely linked to employment and working conditions. Outsourcing and PPPs can have a negative impact as workers in outsourced services are typically confronted with significantly worse employment and working conditions than staff employed by the contracting hospital. At the same time differences within hospitals also tend to increase. For instance, in France, doctors are better paid in the private sector while the wages are lower in this sector for other categories, like nurses or lower qualified workers (Aballea et al., 2006). Similar developments can be observed in privatised hospitals in Germany (Gröschl-Bar and Stumpfögger, 2008). In Germany, furthermore, privatised hospitals have tended to expand the division of work and lower the staff to patient ratio (ibid.; see also Böhlke, 2008). The results are an increasing intensity of work and growing levels of frustration among hospital workers. However, in public hospitals, too, workers suffer from increasing workloads and stress levels as a result of marketisation and the pressure to cut costs.

9.5.4 Equity

While the impact on efficiency and quality are doubtful for privatisation, competition and marketisation, the effects on equity are rather clear. With respect to health insurance, privatisation leads to a deterioration of social equity for several reasons. First, it eliminates the redistributive effect incorporated in the public system. Vulnerable groups may be priced out of the private health insurance market (Colombo and Tapay, 2004). In addition, not only the level but also the type of financing of health insurance has an impact in terms of solidarity: Systems of individual risk-rated premia are highly regressive; systems of group premia within a firm or a community are less regressive and are proportional within this group (Mossialos

et al., 2002). Second, competition between insurers can strongly deteriorate equity if the basic coverage concerns only a limited part of care spending (Bocognano et al., 1999, p. 190). Third, private insurance may also increase inequalities by cream-skimming and selecting the good risks (Mossialos et al., 2002). As a result, it can be observed that people with complementary health insurance tend to use significantly more health care than people that are not covered by such an insurance (Allonier et al., 2008; Jemiai et al., 2004). Several devices can be imagined for palliating these backwards but it has turned out that the level of regulation is often limited for complementary and supplementary insurance (Mossialos et al., 2002).

For their part, out-of-pocket payments are highly regressive. Their effects on inequalities are reinforced when they combine with complementary private insurance, which often compensates for them (Jemiai et al., 2004). In other respects, it seems that cost-sharing reduces the use of preventive services, particularly among vulnerable groups of people, which in the long-term will lead to a deterioration of the general state of health. Forms of marketisation such as the implementation of global budgets and of DRG in hospitals can furthermore increase the risk of cream-skimming as these instruments can incite hospitals to select patients whose treatment will be more simple and who will not risk complications. Similarly, in the case of prospective payments, the networks of general practitioners like the GPFH in the UK could also be tempted to make some cream-skimming, though this was actually limited (Bocognano et al., 1999). The replacement of fee-for-service by capitation for the payment of doctors can also increase the risk of selection of patients for excluding those necessitating frequent visits.

Last but not least, the widening of choices offered by privatisation, which is one of the arguments in favour of privatisation, is in practice limited to the category of people having access to private health insurance and to private clinics or health services, that is, to people who fill criteria evoked above. Moreover, this supposes that people have been given sufficient information for being able to make a choice. This naturally increases transaction costs. In other respects, Thomson and Dixon (2004) show that most patients are conservative and often prefer the existing level of choice available to them, which would limit the interest of having an extended scope.

9.6 Conclusion

The issue of privatisation and of marketisation is particularly complex for health systems as the evolution of insurance schemes and of health care providers shows a growing tendency to mix characteristics usually associated either with public or with private organizations. Even if studies are lacking for assessing all the effects of such a trend, several examples point at its resulting drawbacks for efficiency, quality and, in a major way, equity. These effects demand a wide regulation and control for being corrected, a

complex and costly action which can be more easily applied to the private not-for-profit sector than to the for-profit one.

Notes

1. While the Bismarck system is largely based on mandatory insurance contributions paid from wages, the Beveridge system is mostly financed by taxes.
2. Luxembourg is excluded because of its strong characteristics which make it a case completely apart.

References

Aballea, P., Bras, P.-L. and Seydoux, S. (2006) *Rapport de la Mission d'appui sur la convergence tarifaire public privé* (Paris: IGAS, Rapport No. 2006–2009).
Allonier, C., Dourgnon, P. and Rochereau, T. (2008) *Enquête sur la santé et la protection sociale 2006* (Paris: IRDES).
André, C. (2008) "Privatisation and the Reforms of the European Health Care Systems", Revised Version of the Paper Presented at the PRESOM Health Care and Pension Workshop, Vienna, 4–5 May 2007.
Atun, R. (2007) "Privatization as Decentralization Strategy", in Saltman, R. B., Bankauskaite, V. and Vrangbaek, K. (eds) *Decentralization in Health Care. Strategies and Outcomes* (Maidenhead: Open University Press), pp. 246–271.
Bocognano, A., Couffinhal, A., Grignon, M., Polton, D. and Mahieu, R. (1999) "Mise en concurrence des assurances dans le domaine de la santé. Théorie et bilan des expériences étrangères" in Mougeot, M. (ed.) *Régulation du système de santé* (Paris: Rapport du Conseil d'Analyse Economique), pp. 179–193.
Böhlke, N. (2008) "The Impact of Hospital Privatisation on Industrial Relations and Employees: The Case of the Hamburg Hospitals", *Work Organisation Labour & Globalisation,* Vol. 2, No. 2, pp. 119–130.
Colombo, F. and Tapay, N. (2004) "Private Health Insurance in OECD Countries: The Benefits and Costs for Individuals and Health Systems", *OECD Health Working Paper,* No. 15.
Delorme, R. and André, C. (1983) *L'Etat et l'économie* (Paris: Ed. du Seuil).
Ettelt, S., Nolte, E., Mays, N., Thomson, S. and McKee, M. (2006) "Healthcare Outside Hospital. Assessing Generalist and Specialist Care in Eight Countries", *Policy Brief,* No. 11 (European Observatory on Health Systems and Policies).
European Commission (2008) *Proposal for a Directive on the Application of Patients' Rights in Cross-Border Healthcare* (COM (2008) 414 final, Brussels, 2 July).
Gerlinger, T. and Urban, H.-J. (2007) "From Heterogeneity to Harmonisation? Recent Trends in European Health Policy", *Cadernos Sáude Pública*, 23 Sup 2, pp. 133–142.
Gröschl-Bar, G. and Stumpfögger, N. (2008) "Krankenhäuser" in Brandt, T., Schulten, T., Sterkel, G. and Wiedmuth, J. (eds) *Europa im Ausverkauf. Liberalisierung und Privatisierung öffentlicher Dienstleistungen und Folgen für Tarifpolitik* (Hamburg: VSA Verlag), pp. 165–180.
Ietto-Gillies, G. (2008) "On Quasi-Markets and Privatizations in Public Services", *International Review of Applied Economics*, Vol. 22, No. 3, pp. 387–395.
Jemiai, N., Thomson, S. and Mossialos, E. (2004) "An Overview of Cost-Sharing for Health Services in the European Union", *Euro Observer,* Vol. 6, No. 4 (European Observatory on Health Systems and Policies).

Kozek, W. (2009) *Liberalisation, Privatisation and Regulation in the Polish Healthcare Sector/Hospital* (Research report from the PIQUE project), http://www.pique.at/reports/pubs/PIQUE_CountryReports_Health_Poland_November2006.pdf (accessed 22 January 2009).

Lethbridge, J. (2005) "Strategies of Multinational Health Care Companies" in Mackintosh, M. and Koivusalo, M. (eds) *Commercialisation of Health Care: Global and Local Dynamics and Policy Responses* (Houndmills, Basingstoke, Hampshire: Palgrave Macmillan), pp. 22–37.

Maarse, H. (ed.) (2004) *Privatisation in European Health Care. A Comparative Analysis in Eight Countries* (Maarssen: Elsevier Gezondheidszorg).

Maarse, H. (2006) "The Privatisation of Health Care in Europe: An Eight-Country Analysis", *Journal of Health Politics, Policy and Law*, Vol. 31, No. 5, pp. 982–1014.

Maarse, H. and Meulen, R. T. (2006) "Consumer Choice in Dutch Health Insurance After Reform", *Health Care Anal*, Vol. 14, pp. 37–49.

Martinsen, D. S. (2005), "Towards an Internal Health Market with the European Court", *Western European Politics*, Vol. 28, No. 5, pp. 1035–1056.

Moran, M. (1999) *Governing the Health Care State: A Comparative Study of the United Kingdom, the United States and Germany* (Manchester: Manchester University Press).

Mossialos, E., Dixon, A., Figueras, J. and Kutzin, J. (eds) (2002) *Funding Health Care: Options for Europe* (European Observatory on Health Systems and Policies).

Mossialos, E. and Thomson, S. (2004) *Voluntary Health Insurance in the European Union* (European Observatory on Health Systems and Policies).

Mougeot, M. (ed.) (1999) *Régulation du système de santé* (Paris: Rapport du Conseil d'Analyse Economique).

OECD (2007) *Health Data*.

Oliver, A. and Mossialos, E. (2005) "European Health Systems Reforms: Looking Backward to See Forward?", *Journal of Health Politics, Policy and Law*, Vol. 30, No. 1–2, pp. 8–28.

Pollock, A. M. (2003) *NHS PLC. The Privatisation of Our Health Care* (London: Verso).

Pond, R. (2007) "United Kingdom", *Sozialpolitik in Diskussion*, No. 5, pp. 49–61.

Saltman, R. B. and Figueras, J. (eds) (1996) *European Health Care Reforms* (European Observatory on Health Systems and Policies).

Schulten, T. (2007) "Germany", *Sozialpolitik in Diskussion*, No. 5, pp. 36–48.

Sexton, S. (2003) "Trading Healthcare Away: The WTO's General Agreement on Trade and Services (GATS)" in Katsuri Sen (ed.), *Restructuring Health Services* (London: Zed), pp. 33–52.

Shaoul, J., Stafford, A. and Stapleton, P. (2008) "The Cost of Using Private Finance to Build, Finance and Operate Hospitals", *Public Money and Management*, Vol. 28, No. 2, pp. 101–108.

Thomson, S. and Dixon, A. (2004) "Choices in Health Care: The European Experience", *Euro Observer*, Vol. 6, No. 4 (European Observatory on Health Systems and Policies), pp. 1–4.

Thomson, S. and Mossialos, E. (2004) "Private Health Insurance and Access to Health Care in the European Union", *Euro Observer*, Vol. 6, No. 1 (European Observatory on Health Systems and Policies), pp. 1–4.

10
Privatisation of Education

Wolfgang Blaas, Elsa Hackl and Birgit Mahnkopf[1]

10.1 Introduction

For several years education seems to have been under pressure with regard to its content, organisation and funding. National education systems are being challenged because of shortcomings in teaching and learning. 'Are students well prepared for future challenges?'[2] the OECD is asking, and it assesses the knowledge and skills of students near the end of compulsory education every three years. In the countries that participate in this exercise, a low ranking often translates into a national disaster. At the same time, national governments have ceased to regard education as a core public activity and begun to stress individual responsibility. Consequently, liberalisation, deregulation, privatisation and marketisation have spread in diverse forms and to various extents on different levels of the educational systems of EU member countries – from pre-elementary to higher education and vocational training institutions. This is the topic of the current chapter.

Privatisation in education is an extremely complex matter. In order to sort out this complexity the chapter starts by discussing the functions of education (Section 10.2.1) and then looks at the various dimensions of education privatisation (Section 10.2.2).

The main parts of this chapter (Sections 10.3 to 10.4) focus on tertiary education, though occasionally other levels of education are dealt with. The first reason for this focus is that discussing all sectors of education[3] would exceed the available space. Second, students and teachers in tertiary education are internationally mobile, which exposes tertiary institutions increasingly to (international) competition. Private providers are often considered better organised to succeed in this competition. Third, we focus on tertiary education because, at least in the EU, private expenditure as a percentage of total education expenditures is higher than in any other level of education. Finally, privatisation in tertiary education seems further advanced than in the other sectors.

Hence, the statistical overview of education expenditures and providers given in Section 10.3.1 and the presentation of the diversity of education systems in Europe in Section 10.3.2 concentrate on the tertiary level of education, as does the discussion of the various privatisation routes which have been followed in Europe (Section 10.4.). Finally, in Section 10.5, conclusions will be drawn and perspectives will be discussed.

10.2 Relevant concepts

Before dealing with data and the various privatisation routes in European countries, we want to discuss concepts relevant in this context.

10.2.1 Functions of education

There is a general agreement that education fulfils social, economic and political functions. Since privatisation may have an influence on all different functions it seems appropriate to briefly discuss them.

Social functions The close relationship between school education and socialisation has been analysed from different perspectives. According to Talcott Parsons' functionalism, schools, in addition to families, are the main agents of socialisation (Parsons, 1964). Through schooling, individuals are integrated into society by internalising its norms and values and they are socialized to conform to them.

A further social (and political) function of education is to provide social mobility, and a decent education is seen as the prerequisite to escape the lower social strata. The general conclusion of empirical enquiries into this question is that, the more difficult the access to education for lower social groups, the higher the probability and the danger of segmentation of society into relatively poor and relatively better-off parts.

Economic functions The economic function clearly dominates the current debate. Due to the key role of knowledge for innovation and therefore for economic growth, and due to the collective and social dimensions of sharing knowledge of different types, education helps to increase the productivity of labour and enables the individual to participate in innovations of all kinds. Hence, education is seen as an *investment in human capital*. However, since there are individual and social returns to this investment, the question remains: who ought to invest, the individual or the society? This is, of course, a crucial question when dealing with privatisation of education.

The OECD, endorsing the human capital approach, gives an answer to this question. In a study of 11 OECD countries it is found that "public rates of return for completing tertiary education are lower than private rates of return in all countries (...)" (OECD, 2007a, p. 152). It is therefore argued that it is the individual person who is primarily responsible for investing in tertiary education. The obvious consequence thereof is the support of privatisation of tertiary education.[4]

Political functions In a democracy, the function of education consists in enabling the individual to exercise his or her rights to participation in political decision-making. In this function, the education system contributes considerably to the functioning of a democratic society.

In order to be able to fulfil this political function schools are to educate individuals critical towards their own life and personality, but also critical towards established knowledge and powers.

Inconsistency of functions? Thus, modern democratic societies are faced with a plurality of goals and contents of education, as well as with potential inconsistencies between them, notably between the political and the economic functions. While the former aims at the individual's ability to judge and criticise, the latter is orientated towards the wealth of the individual and the society (Baethge, 1970).

10.2.2 What is privatisation of education?

Privatisation has been defined as "the transfer of activities, assets and responsibilities from government and public institutions and organizations to private individuals and agencies" (Belfield and Levin, 2002, p. 19). With regard to education, two forms have been distinguished: privatisation *in* education and privatisation *of* education. The first is an endogenous privatisation and means the import of ideas, techniques and practices from the private sector in order to make the public sector more business-like. The second, exogenous privatisation, corresponds with the above-quoted definition (Ball and Youdell, 2008).

In our context, we will deal with three variants of privatisation, namely:

1. private provision of education;
2. private funding of education; and
3. business-like organisation of education institutions.

Private provision Here privatisation means the transfer from state or public provision and management of educational institutions or services to private agencies and organisations, for example to religious groups, charities, firms, and others.

Private funding In this case, privatisation means that parents and students pay directly for educational services rather than indirectly through their taxes. In most cases, however, families and governments share the costs of education. Tuition fees, for example, usually cover only a certain fraction of total costs of a university education, and therefore have to be complemented by public funds.

Business-like organisation of schools Competition, choice, performance and accountability are all part of the so-called *New Public Management (NPM)* concept. In education this means that even when schools are still

funded and provided by governments, the 'running' of schools follows a business-like paradigm. Students become clients or customers of education-companies (schools) and competition rules as prime motivation for schools, teachers and students. The focus is on outcomes that can be measured. This kind of privatisation is not only changing the behaviour of students and teachers, but also the discourse and thinking of policymakers and the society at large.

Besides, when schools can be run like businesses – why not privatise them in the sense of changing the 'owners'? It can easily be understood that the economic function of education has its counterpart in this endogenous privatisation.

Combining variants of privatisation programmes All types of privatisation may be implemented simultaneously and enhance each other. But they may also balance each other. For example, the private provision of education may be complemented by strict government regulations of teaching and materials used in school. On the other hand, also substitute relationships exist between different forms of privatisation. Examples are vouchers that are offered to enable parents and their children to choose a school or tax credits that are granted to parents in order to finance school fees.

The combination of public and private characteristics may result in quasi-markets for education, with governments retaining an important role in terms of setting standards, while (private and public) suppliers operate in a regulated competitive environment.

10.3 European education systems

10.3.1 Statistical overview

UOE[5] data give a first impression of public and private expenditures on education as well as on public and private providers in education.

10.3.1.1 Expenditure on education

Overall expenditures on education According to these data (OECD, 2008, p. 237, table B2.1) the (not-weighted) average of overall expenditures on education as a percentage of Gross Domestic Product (GDP) of the EU19 countries[6] was 5.5 per cent in 2005, which is slightly below the OECD average of 5.8 per cent. In Denmark and Sweden, the expenditure rates were significantly higher, and in Belgium, Finland, France and the United Kingdom they were well-above the average rates (at least 6 per cent). Six of the EU19 countries spent less than 5 per cent of GDP on education, the lowest figure being 4.2 per cent in Greece.

On the other hand, Greece has been successful in increasing the expenditure ratio significantly in the long run (by 1.6 per cent points from 1995 to 2005), a performance which only Denmark has been able to come near

(1.2 per cent point), albeit starting from a higher level of the expenditure ratio. Many other countries experienced falling or stagnating expenditure ratios. For example, in Austria, Ireland and Spain the increases in expenditure on education between 1995 and 2005 tended to fall behind the growth in national income and in countries like the Czech Republic expenditures did not increase significantly with economic growth. This seems to be at odds with the target of the EU to become a 'knowledge-based society', with 'human capital upgrading' being the most important objective in the near future.

The picture differs when the expenditures on education are analysed by sector (OECD, 2008, p. 239, table B2.3). On average in the EU19, tertiary education expenditures grew much stronger (1995–2005) than expenditures for non-tertiary education (48 per cent versus 30 per cent in real terms). This is true for most EU19 countries but in Belgium, Denmark, Finland, Hungary, Ireland and the Netherlands expenditures increased equally or even stronger in non-tertiary education. In two member states, namely Poland and Greece tertiary education expenditures have more than doubled (in real terms) during these ten years.

Despite these positive developments, the EU19 average of expenditures for tertiary education as a percentage of GDP continued to remain at 1.3 per cent (2005), while this share is 2.9 per cent in the USA. Therefore, the European Commission states that "funding for universities is far too low compared to our major competitors, both in education and research" (EC, 2006). This 'education gap' is also be underlined by enrolment rates in tertiary education, which are at 57 per cent in Europe as compared to 81 per cent in the US.

Public and private expenditures on education On all three educational levels which are analysed by OECD, public sources are dominant in the EU19. In 2005, public funding represented 90.5 per cent for all levels of education combined, while private funding, including subsidies attributed to payments to educational institutions received from public sources, represented just 9.5 per cent (OECD, 2008, p. 251, table B3.1). In pre-primary education, public expenditures on average amounted to 87.9 per cent of the total expenditures, in primary, secondary and other non-tertiary education the public share was 93.8 per cent and in tertiary education this share was 82.5 per cent (see Table 10.1).

In tertiary education, the share of public funds differed significantly between countries, ranging from 67 per cent in the UK to almost 97 per cent in Denmark and Greece. However, private sources are gradually replacing public ones. In tertiary education (OECD, 2008, p. 253, table B3.2b) and on average in the EU19 countries, public expenditures have gone up by 27 per cent from 2000 to 2005, while private expenditures have increased by 234 per cent. Over the same period, the share of public funding of tertiary education has decreased in all EU19 countries.

Table 10.1 Proportion of public and private expenditure on educational institutions as a percentage, by the level of education (2005)

	Pre-primary education (for children 3 years and older)		**Primary, secondary, post-secondary non-tertiary education**		**Tertiary education**	
	Public sources	**All private sources***	**Public sources**	**All private sources***	**Public sources**	**All private sources***
Austria	65.9	34.1	94.3	5.7	92.9	7.1
Belgium	96.1	3.9	94.7	5.3	90.6	9.4
Czech Republic	89.6	10.4	89.9	10.1	81.2	18.8
Denmark	80.8	19.2	97.9	2.1	96.7	3.3
Finland	91.1	8.9	99.2	0.8	96.1	3.9
France	95.5	4.5	92.5	7.5	83.6	16.4
Germany	72.1	27.9	81.8	18.2	85.3	14.7
Greece	x(3)	x(4)	92.5	7.5	96.7	3.3
Hungary	94.3	5.7	95.5	4.5	78.5	21.5
Ireland	m	m	96.8	3.2	84.0	16.0
Italy	91.1	8.9	96.3	3.7	69.6	30.4
Luxembourg	m	m	m	m	m	m
Netherlands	97.1	2.9	96.0	4.0	77.6	22.4
Norway	87.2	12.8	m	m	m	m
Poland	88.3	11.7	98.2	1.8	74.0	26.0
Portugal	m	m	99.9	0.1	68.1	31.9
Slovak Republic	78.6	21.4	86.2	13.8	77.3	22.7
Spain	84.9	15.1	93.5	6.5	77.9	22.1
Sweden	100.0	n	99.9	0.1	88.2	11.8
Switzerland	m	m	87.0	13.0	m	m
United Kingdom	92.9	7.1	83.0	17.0	66.9	33.1
EU19 average	*87.9*	*12.1*	*93.8*	*6.2*	*82.5*	*17.5*
OECD average	*80.2*	*19.8*	*91.5*	*8.5*	*73.1*	*26.9*
Australia	67.5	32.5	83.6	16.4	47.8	52.2
Korea	41.1	58.9	77.0	23.0	24.3	75.7
United States	76.2	23.8	91.0	9.0	34.7	65.3

Symbols for missing data: m data is not available, n magnitude is either negligible or zero, x data included in another category or column (for example x(3) means that data are included in column 3 of the table).

*Including subsidies attributable to payments to educational institutions received from public sources.

Sources: OECD (2008), p. 252, Tables B3.2.a and p. 253, B3.2b

Compared to other OECD countries such as the United States, Australia, Japan and South Korea, where between one-third and more than half of the expenditures on tertiary education institutions are covered by private sources, the proportion of private expenditures in EU19 countries is still low (ibid.).

10.3.1.2 Providers of education

Public funding of education does not necessarily mean that education is provided by public institutions alone. In all countries, the share of students in primary and secondary schools without substantial public funds is quite small (OECD, 2008, p. 346, table C2.4). In 2006, on EU19 average only 2.7 per cent of students in primary schools were enrolled in schools that received less than 50 per cent of their core funding from governments ('independent private schools'), 7.9 per cent were in 'government-dependant private schools' (receiving more than 50 per cent from governments) and 89.9 per cent were in public schools. The percentage of students in public schools declined with the educational level: in upper secondary education the respective percentages were 83.3 (public schools), 13.4 (government-dependent private) and 3.9 (independent private).

The OECD average did not differ significantly from that of the EU19. However, in the United States the share of students in private institutions was higher in primary education (9.8 per cent) than in secondary education (8 per cent) and the principle 'He who plays the pipe calls the tune' seems to prevail as there are no government-dependent private institutions.

In tertiary-type A[7] education, just about 7 per cent of the students were enrolled in independent private institutions on EU19 average, approximately 12 per cent study in government-dependent private institutions and about 82 per cent in public institutions. The share of students in private institutions was higher in the vocational-oriented tertiary-type B sector[8], where 20.7 per cent of the students were in government-dependent and 6.1 per cent in independent institutions and only 68.3 per cent in public institutions. In contrast PhD programmes were rarely offered by private institutions.

Again, there was a marked difference to the United States where a government-dependent private sector does not exist and where approximately 80 per cent of the students were in public institutions and 20 per cent in independent private institutions. According to OECD data, the most striking difference – both to Europe and the United States – is with Korea, where the overwhelming share of students in tertiary education (more than 80 per cent) were in independent private institutions (Table 10.2).

Unlike data on private expenditures those on private providers do not adequately reflect ongoing changes: In the first place because data on providers have only been published since 2006 in 'Education at a Glance' and second, because UOE data are based on a legal definition of public and private institution[9] that does not allow one to grasp the complexity

Table 10.2 Percentages of students in tertiary institutions by type of institution (2006)

	Tertiary-type B education			Tertiary-type A education		
	Public	**Government dep. private**	**Independent private**	**Public**	**Government dep. private**	**Independent private**
Austria	67.3	32.7	x(2)	88.8	11.2	n
Belgium	46.6	53.4	a	42.5	57.5	a
Czech Republic	67.2	31.9	0.9	91.7	n	8.3
Denmark	98.2	1.8	n	98.1	1.9	n
Finland	100.0	n	a	89.5	10.5	a
France	72.1	8.3	19.6	87.1	0.7	12.3
Germany	62.6	37.4	x(2)	95.9	4.1	x(5)
Greece	100.0	a	a	100.0	a	a
Hungary	59.5	40.5	a	86.5	13.5	a
Ireland	93.3	a	6.7	91.6	a	8.4
Italy	88.6	a	11.4	92.8	a	7.2
Luxembourg	m	m	m	m	m	m
Netherlands	n	n	n	m	m	m
Norway	56.4	43.6	x(2)	86.7	13.3	x(5)
Poland	77.7	n	22.3	69.1	a	30.9
Portugal	68.1	a	31.9	75.1	a	24.9
Slovak Republic	86.5	13.5	n	95.7	n	4.3
Spain	79.1	15.6	5.3	87.7	n	12.3
Sweden	61.7	38.3	n	93.8	6.2	n
Switzerland	29.9	39.5	30.6	92.2	5.7	2.2
United Kingdom	a	100.0	n	a	100.0	n
EU19 average	*68.3*	*20.7*	*6.1*	*81.5*	*12.1*	*6.8*
OECD average	*65.5*	*19.1*	*13.8*	*78.5*	*9.1*	*13.9*
United States	84.3	a	15.7	71.9	a	28.1
Australia	96.7	1.7	1.6	98.0	n	2.0
Korea	15.9	a	84.1	22.2	a	77.8

Symbols for missing data: a data is not applicable, because the category does not apply, m data is not available, n magnitude is either negligible or zero, x data included in another category or column (for example x(2) means that the data are included in column 2 of the table).
Source: OECD (2008), p. 347, Table C2.5

and diversity of privatisation. For example, UK tertiary education institutions are categorised as government-dependent private because they are private law entities. Austrian universities, in contrast, are classified as public, because they are public law entities, although in fact they resemble private corporations and government policy is perhaps less influential and effective than in the UK.

In any case, in Europe, despite its diverse educational traditions and systems it still seems widely accepted that education is a public responsibility and therefore a public good – with only a small portion of students in privately run and funded institutions. However, there is a blurring of public and private (Enders and Jongbloed, 2007, p. 20) as private expenditures for education – also in public institutions – increase and as education institutions are becoming business-like organisations ('endogenous privatisation'), irrespective of whether they are based on private or public law.

10.3.2 Diversity of education systems in the EU and common challenges

Tertiary education systems in Europe differ significantly, and EU documents on education usually also stress their respect of cultural diversities and national traditions. Normally, three distinctive models are being distinguished in European higher education. These have been described as the 'personal development model' (UK), the 'Humboldtian or research model' (Germany), and the 'professional training model' (France) (Gellert, 1999, p. 14). All three models were developed at a time when only a small portion of the population received higher education and they have since come under pressure.

In all countries of the European Union enrolment rates in tertiary education have continued to increase in the last decade. In 2005, more than 18 million students were enrolled in the 27 member states of the European Union as against approximately 15 million in 1998, which is an increase of more than 20 per cent.[10] In 2006 on EU19 average entry rates into tertiary education rose to almost 70 per cent (OECD, 2008, p. 69, table A2.5). In a number of countries spending per student at the tertiary level has fallen as expenditures did not keep up with expanding student numbers.

A demand for tertiary education that exceeded supply coincided with financial stringency. All over Europe – due to the ideology of a lean government and/or the imposition of the Maastricht criteria – rigid budget policies prevailed. Efficiency and cost effectiveness have ever since dominated the discourse. On this basis, privatisation in tertiary education, differing by national tradition and circumstance with regard to the adopted policy response, has become a noticeable feature in Europe.

But it would be inaccurate to speak of converging (tertiary) education systems in Europe. Similar to the emergence of diverse state education systems (Archer, 1984), national policies responded differently to the abovementioned common circumstances. Significant national variations persist

with regard to fees and funding regimes (Andersen and Pechar, 2008) as well as to governance.

10.4 Transformation of universities

Drawing on the country studies that contributed to this report, this chapter discusses privatisation strategies in tertiary education in different European countries.

10.4.1 Private funding of tertiary education: Fees

Most countries tried to increase private funds for universities by stimulating first contract research and later private revenues from teaching. With the exception of some niches, the European member countries had either abolished student fees in the course of the expansion of the welfare state or during the state socialist period in the Central and East European (CEE) countries fees have remained very moderate. From the 1980s onwards fees have been advocated by human capital theorists on grounds of the individual benefits from education and as an option to fund the continuous increasing demand for education.

In the CEE countries universities suffered from extreme underfunding after the collapse of the former regimes. In these countries governments limited access to tertiary education by a defined number of available places and competitive entrance exams. Students that were accepted did not pay fees and their living and housing were subsidised. Free of charge tertiary education was in most cases even guaranteed by constitutional law. In the course of the transformation process both the demand for education as well as the demand of institutions for extra-budgetary funds rose. Universities began to accept – in addition to the number of students that was defined and (increasingly poorer) funded by governments – students that had to pay for their studies. To circumvent the still valid legal ban on fees these students were formally admitted as evening or part-time students. In most CEE countries this two-track financial regime has been introduced at the beginning of the 1990s. It represents the first step in introducing fees in Europe and it still prevails.

In the old EU member states fees were introduced almost a decade later – for example, in 1998 in the UK, in 2001 in Austria,[11] and 2007 in seven of the German Länder. They are either – by international comparisons – not substantial (Austria) or accompanied by subsidised loan schemes (UK).

However, this should not lead to underrating the financial burden on students. Study fees are not the only costs; public subsidies for living costs, too, are increasingly reduced or granted only on a loan basis and subject to repayment. The growing individual costs of tertiary education include furthermore the risks resulting from quickly changing qualification demands, expressed by the discourse on mobility, flexibility and lifelong learning.

10.4.2 Private provisions

As has been the case with fees, private tertiary institutions, too, have not played a significant role in EU member states. Traditionally, higher education institutions have been public, although – due to differences in state formation – their organisation varied widely as did other branches of public administration. The close links between the nation-state and the university (Kwiek, 2006) resulted from its function to educate the political elite. Technical and vocational skills, needed by the private sector, developed outside the universities and were incorporated into universities rather hesitantly. Hence, the private sector became a major employer of university graduates only much later.

Apart from Catholic universities in some countries, most prominent in Belgium and the Netherlands, private universities first became a political issue when governments reformed universities in order to improve and democratise them. In this context, ideas on 'alternative models of universities' emerged. In the mid-1970s in the UK, libertarians, neoliberals and academics, averse to the changes that had taken place, established the University of Buckingham. Approximately ten years later, for similar reasons, the private university Witten/Herdecke was founded in Germany. Again almost ten years later a new series of private institutions emerged all over Europe. However, this time the governments paved the way for the establishment of private institutions.

With ever more graduates getting jobs in private companies, university education had to adapt: neither their specialisation nor the content of the courses nor the university type of learning and teaching seemed adequate to prepare for the labour market. In most countries, a diversification of programmes and courses had taken place since the 1970s (establishment of polytechnics, 'Fachhochschulen' or similar non-university higher education institutions).

Austria, which had not diversified higher education in the 1970s, came under pressure at the beginning of the 1990s when preparing for accession to the European Union. Her vocational education system was assumed not to comply with Directive 89/48/EEC.[12] Consequently, in 1993 a 'Fachhochschule' sector was established. Rigid budgets (Maastricht criteria) encouraged the adoption of a law that envisaged privately run institutions, subsidised by the federal government. In Austria, these were the first private tertiary institutions, although in many cases they are actually owned and run by regional governments. This means that legally – as tertiary education is a federal competence – they are private, but virtually and economically they are public. Finally, a law permitting and regulating the establishment of private universities followed in 1999.

In *Italy* and *Greece*, a demand that could not be met by public universities stimulated the establishment of private institutions.[13] In this context the case of Greece is of special interest. Access to universities is regulated via a

competitive national entrance exam. According to the Greek Constitution[14] higher education is only to be provided by state institutions. This regulation produced an unusually large number of students studying abroad.[15] To be recognised in Greece, foreign degrees had to pass a procedure on equivalence administered by a special body. In the 1990s private institutions which already offered tertiary education but were not officially recognised, affiliated with foreign universities in Europe and the United States. Upon non-recognition of a degree obtained from such an institution, the case was taken to the European Court of Justice (ECJ) that ruled that non-recognition violated EU law.[16] The Court based its decision on articles 48 (free movement of workers), 52 (freedom of establishment), 126 (cooperation in education) of the European Commission (EC) treaty and on the above-mentioned Directive 89/48 EEC. The decision makes clear that the recognition of degrees and qualifications is no longer a national prerogative and state institutions are no more in a monopolistic position. Private and public universities of a member state may supply their services in other member states. From the legal point of view of the receiving country, they are in both cases private institutions. The case provides a good example of how the expansion of EU competence in education proceeds via liberalisation and privatisation.

An unmet demand for tertiary education and the requirement to educate for the new private sector enhanced the establishment of private tertiary education institutions in *transition countries*, notably for teaching subjects like business studies, languages, law and so on. Today, in *Poland* and the *Czech Republic*, for instance, the number of private institutions exceeds that of public ones, although with regard to student numbers the latter still dominate (OECD, 2007b, pp. 18–21). In this context another aspect of the blurring between public and private may be observed, namely the fact that the teaching staff of public universities is also lecturing in private institutions.[17]

In sum, despite the fact that most European countries still adhere to the idea that tertiary education is to be financed to the larger part publicly and most institutions are still regarded as public ones, in the 1990s private institutions gained ground. Three factors that enhanced this development may be identified: First, a 'vocational drift'[18] of tertiary education with new skills demanded by the market, second, a quantitatively unmet demand for tertiary education, notably in transition countries, and third, a blurring between public and private resulting from liberalisation and deregulation.

10.4.3 New Public Management (NPM) and liberalisation

The continuous expansion of tertiary education coupled with financial bottlenecks did not in the first place entail the introduction of fees or the establishment of private education institutions. Rather, beginning with the 1980s, governments in Europe began to modify their steering and funding regimes. 'Institutional autonomy', 'accountability' and 'efficiency' became the catchwords. 'Institutional autonomy' is a concept used specifically in the context of university governance and implies deregulation and decentralisation.

This transfer of responsibilities to the institutional level entailed a swift to NPM – or 'endogenous privatisation'. Its tools – steering by outcome, indicators, quality control, regular assessments, and performance contracts – were incorporated in tertiary education reforms.[19] Today, they are inherent parts in the discourse on and governance of tertiary education, both at the national as well as on the European level.

However, transforming universities was a rather long process involving a range of expert reports,[20] white papers and new legislations. The process gained momentum through the creation of a European Higher Education Area (EHEA).

At first, since the mid-1980s, the European Commission and the ECJ took the lead in expanding Community competences and creating a 'common area' in higher education. The ECJ developed the right to free movement of students[21] and a decade later applied freedom of establishment to universities. By its decisions, the ECJ curtailed national legislation and policymaking in tertiary education. However, the only way to expand EU competences in the framework of the Treaty (or former Treaties) in force is by liberalisation. The latter means gradually abolishing the monopoly of the member states for regulating and providing tertiary education and instituting privatisation. In addition, the Commission set up the ERASMUS programme that contributed not only substantially to rising student mobility but also to Europeanise tertiary education. The diverse national systems of education in Europe "started to emerge as a significant obstacle to the new European political agenda encompassing the principles of free mobility, cross border employability, etc. in societies at large as well as in their respective higher education system" (Zgaga, 2007, p. 27).

At the end of the 1990s, the creation of the EHEA became an intergovernmental activity. First, only four countries were involved (Sorbonne Declaration 1998: France, Germany, Italy and the UK), but a year later education ministers of all EU member states met in order to establish a process to implement the EHEA (Bologna Process). The efforts concentrated primarily on the harmonisation of degree structures, but the EHEA entailed also organisational reforms as universities must be able to act freely within this area without being constrained by national governments.

It is for this reason that the Bologna Process encouraged 'institutional autonomy' and the denationalisation of universities. Thus, the EU member states finally propelled the process which has been started by the Commission and ECJ about a decade earlier.

10.4.4 Competition state and tertiary education

In the mid-1990s Hirsch (1995), Cerny (1997) and others observed that the state's objectives were concentrated increasingly on locating economic activities in its own territory (location competition) and the term 'competition stat' was coined. "Rather than attempt to take certain economic activities out of the market, to 'decommodify' them as the welfare state was organized

to do, the competition state has pursued increased marketisation…" (Cerny, 1997, p. 259).

In addition to transforming universities into business-like institutions and into actors on the international market three other developments may be associated with these developments: first, the stress on what has been called *'vocational drift'* and *'employability'*, second, the creation of so-called *centres of excellence* as well as an '*hierarchisation*' of institutions and third *selling* in the sphere of education.

As mentioned above, the increase of students in higher education went along with educating for an increasing number of areas and upgrading the training for vocational activities. But traditional academic disciplines, too, were subject to reforms of their curricula, to define learning outcomes in order to demonstrate the employability[22] and the entrepreneurial skills of their graduates. This policy fits with the consideration that a well-trained labour force is of decisive importance when companies choose a site.

Similarly, the location of top research institutions in a territory is held to be of prime importance in competition policy. In Europe – with some exceptions – universities traditionally were thought to be peers. At the beginning of this millennium the situation began to change and the creation of centres of excellence or elite universities became a must.[23] The identification of institutions or research areas was led by the idea of regional competitiveness and happened in close cooperation with representatives of the economy (Hackl, 2007; Vibro, 2007).

Selling of education services and research activities was first pushed by financial stringencies. However, it developed from an innovative way for universities to attract extra funds, to a must, a normal performance. Therefore it represents a good example for how commodification may proceed. Meanwhile, universities not only look for wealthy students from abroad, but they sell their expertise and institutional knowledge as well. The UK is most advanced in this context (Ball, 2007). Ideas, however, spread quickly as, for example, to Germany (Quaißer, 2007) and think tanks everywhere are active in promoting this development.

10.5 Conclusions and perspectives

Although in detail national responses to common challenges varied widely within the EU, some general tendencies prevail. First, the introduction of tuition fees has been a common response in almost all EU member states. The most notable exception was Ireland which abolished tuition fees in 1993 – although retaining rising registration fees. A second common but still weak pattern is the development of an independent private sector in tertiary education. Third, and the most striking common feature of European tertiary education, is the expansion of a *government-dependent private tertiary education sector*, or more generally speaking, the emergence of private

providers funded by the taxpayers. This has multiple reasons. It is a result of inabilities of traditional bureaucratic systems to cope adequately with large tertiary education systems. This facilitated the introduction of NPM techniques that have dominated the discourse on public services for decades in education institutions. It is furthermore a result of liberalisation, aiming at a stronger European cooperation and (inter)national competition. Finally, it also results from shifting the focus of tertiary education from education for citizenship to employability for the market.

With the expansion of the (government-dependent) private sector, competition, heterogeneity and hierarchy in tertiary education have become more pronounced,[24] and hence, tertiary education has become more unequal. The rising numbers of students in tertiary education ('mass/universal higher education') do not imply that equal opportunities in education have increased. It means that the inequalities that formerly existed between those with and without higher education exist now between graduates from prestigious and less prestigious institutions. In case prestigious institutions charge high fees and as they constitute networks for careers, the tertiary system is socially selective and hence it is stabilising inequalities.

In case primary and secondary education are – as data imply – subject to the same trend, then social selectivity is not only aggravated and brain waste intensified but there are also a number of more *general consequences*. Cross-country studies have shown that educational inequality is closely related to income inequality (for example Green, Preston and Sabates, 2003), which translates in the long run into lower *economic growth* (Aghion et al., 1999). Furthermore, it has been shown (Green, Preston and Sabates, 2003) that educational inequality undermines key aspects of *social cohesion* such as social and institutional trust, civic cooperation and the rule of law. And it has also been demonstrated how more egalitarian education systems are conducive to social cohesion. The crucial point in these studies is that, for social cohesion, what matters is not the level of skills but how they are distributed.

Finally, the loss of *democratic accountability* has been seen as the price to be paid for more individual choices and more economic efficiency. That there might exist such a trade-off is one of the findings of Beermann (2001). Beermann looks at the impact on political accountability of different types of privatisation, namely (1) divestiture (selling government assets and government owned enterprises); (2) contracting out with private parties for performance; (3) deregulation and vouchers; (4) tax reduction and employing user fees. In the context of education, types (2) to (4) are relevant.

Contracting out education services can raise serious accountability issues. For example, if a public education authority decides to hire a private company to operate a public school or university, it is not clear ex ante to what extent the public via its authority will be able to control the operations of the school. Even if this authority maintains ultimate control through the

choice of the contraction party, accountability can be reduced if effective mechanisms are lacking, which maintain control over the details of school (university) operation. In sum, the public authority/private company relationship raises the principal-agent problem.

Deregulation is based on the idea that transferring law-making competence from the state to the institutional level results in efficiency gains. It is argued that decisions should not be taken by the government that acts for all citizens, but only by those citizens that are involved or affected. However, the relevant stakeholders are not easy to identify. Consequently, in case not all parties are involved in decision-making at the institution level, deregulation reduces democratic accountability. The argument for vouchers is that they allow free school choice. In this sense, vouchers substitute the market rationale for democratic decision-making and control of schools. They tend to widen quality gaps between schools and hence widen social inequalities.

Concerning user fees, it seems unclear how they affect political accountability. On the one hand, no large effects on accountability are to be expected whether government activities are associated with user fees or not, since their accountability is warranted by the political decision process itself. On the other hand, financing government activities through user fees can provide accountability by applying a measure of market discipline to government, and the imposition of user fees may also increase the beneficiaries' incentives to monitor government's performance.

Hence, the accountability issue for education privatisation seems to be an open question. Whether it is to be assessed positively or negatively may only be judged from case to case, and the crucial question might be how detailed and comprehensive the public may control education providers.

Notes

1. Contributing with country studies: Danes Brzica, Mejra Festic, Gunter Quaißer, Rosa Toliou, Nicola Acocella and Federico Tomassi.
2. www.pisa.oecd.org: The OECD Programme for International Student Assessment (PISA) (12 February 2008).
3. Generally three levels of education are distinguished by OECD, Eurostat and Unesco: (1) pre-primary level; (2) primary, secondary and post-secondary non-tertiary level; (3) tertiary level.
4. The OECD may be seen as one of the main drivers of privatisation of education, and increasingly so since its active support for General Agreement on Trade in Services (GATS).
5. Data on education collected by **U**nesco-Uir, **O**ECD and **E**urostat. The data referred to in this section are based on OECD, Education at a Glance 2008 in order to compare Europe with non-European countries. For Europe they are published by the Commission in 'Key Data on Higher Education'.

6. For many indicators the OECD study presents also an 'EU19' average. It is calculated as the unweighted mean of the data values of the 19 OECD countries that are members of the European Union and for which data are available or can be estimated. These 19 countries are Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Italy, Ireland, Luxembourg, the Netherlands, Poland, Portugal, the Slovak Republic, Spain, Sweden and the United Kingdom.
7. Tertiary-type A (ISCED 5A) refers to three to six years (and more) of higher education, including also PhD-programs (ISCED6).
8. Tertiary-type B (ISCED 5B) are typically shorter (minimum duration two years) than tertiary-type A programmes and focus on practical, technical, occupational skills for direct entry to the labour market.
9. OECD 2007a, Annex 3 EAG: Educational institutions are classified as either public or private according to whether a public agency or a private entity has the ultimate power to make decisions concerning the institution's affairs.
10. www.epp.eurostat.ec.europa.eu (9 June 2008).
11. Before the recent elections (2008), fees have been abolished for students that finish their studies within the legally defined duration of the course. As the regulation includes several exceptions it is very complicated to implement. Therefore, it is not yet clear whether it will endure.
12. Directive for a general system for the recognition of higher education diplomas awarded on completion of professional education and training of at least three years' duration, 89/48/EEC of 21 December 1988.
13. For private education in Italy see Acocella and Tomassi, 2007; for Greece see Toliou, 2007.
14. Article 16 (5).
15. According to Eurostat the Greek percentage of all students studying in another EU member state is, at 6 per cent, significantly above the EU average of 2 per cent.
16. Vagias vs. DI.K.A.T.S.A, decision no. 2808/1997 of 8 July 1997.
17. This is not only true for CEE countries, see, for example, Festic, 2008, OECD, 2007b, but also for other EU member states, for instance Austria.
18. In the course of diversification the term 'academic drift' was coined in order to describe the tendency of non-university institutions to become university like. Subsequently, the term 'vocational drift' was coined in order to describe the adverse trends, namely the tendency of universities to offer more vocationally oriented programmes.
19. A good example is for instance Austria's University Act of 2002.
20. Best known examples are in the UK the Dearing Report, 1997 and in France the Attali Report, 1998.
21. Case 293/83 Gravier v. City of Liège [1985] EC R 593.
22. This concept became a leading principle in restructuring the university studies in the course of the Bologna Process.
23. 'The role of universities in the Europe of knowledge'. Communication from the Commission of 5 February 2003. http://europa.eu/scadplus/leg/en/cha/c11067.htm
24. The term 'tertiary education' instead of 'higher education' has been coined exactly for expressing this development.

References

Acocella, N. and Tomassi, F. (2007) "Public and Private Components in the Italian Educational System", *Der Öffentliche Sektor – The Public Sector,* Vol. 33, No. 3, pp. 41–49.

Aghion, P., Caroli, E. and Garcia-Penalosa, C. (1999) "Inequality and Economic Growth: The Perspective of the New Growth Theories", *Journal of Economic Literature,* Vol. XXXVII, pp. 1615–1660.

Andersen, L. and Pechar, H. (2008) *Higher Education Funding and Welfare Regimes: International Comparative Perspectives* (Paper Presented at the Annual Meeting of the American Educational Research Association, New York).

Archer, M. (1984) *Social Origins of Educational Systems* (London: Sage).

Baethge, M. (1970) *Ausbildung und Herrschaft* (Frankfurt/Main: Europäische Verlagsanstalt).

Ball, St. J. (2007) "Globalised, Commodified and Privatised: Current International Trends in Education and Education Policy", *Der Öffentliche Sektor – The Public Sector,* Vol. 33, No. 3, pp. 33–40.

Ball, St. J. and Youdell, D. (2008) "Hidden Privatisation in Public Education", *Professional Magazine*, November, pp. 22–25.

Beermann, J. M. (2001) "Privatisation and Political Accountability", *Fordham Urban Law Journal*, pp. 1507–1558.

Belfield, C. R. and Levin, H. M. (2002) *Education Privatisation: Causes, Consequences and Planning Implications* (Paris: UNESCO International Institute for Educational Planning).

Cerny, Ph. G. (1997) "Paradoxes of the Competition State: The Dynamics of Political Globalization", *Government and Opposition*, Vol. 32, No. 2, pp. 251–275.

Enders, J. and Jongbloed, B. (2007) *Public-Private Dynamics in Higher Education. Expectations, Developments and Outcomes* (Bielefeld: Transcript).

European Commission (EC) (2006) *Frequently Asked Questions: Why European Higher Education Systems Must Be Changed?* (Press Releases, 10 May 2006, Brussels), http://europa.ed/rapid/pressReleasesAction.do/reference=MEMO/06 (accessed 21 January 2008).

Festic, M. (2008) *The Fundamental Problem in Higher Education in Slovenia* (draft contribution to the PRESOM project).

Gellert, C. (1999) "Introduction. The Changing Conditions of Teaching and Learning in European Higher Education", in Gellert, C. (ed.), *Innovation and Adaptation in Higher Education* (London: Kingsley).

Green, A., Preston, J. and Sabates, R. (2003) "Education, Equity and Social Cohesion: A Distributional Model", *Wider Benefits of Learning Research Report,* No. 7.

Hackl, E. (2007) *The Creation of a Centre of Excellence: The Austrian Example* (Paper presented at the CHER Annual Conference).

Hirsch, J. (1995) *Der nationale Wettbewerbsstaat. Staat, Demokratie und Politik im globalen Kapitalismus* (Berlin: Edition ID-Archiv).

Kwiek, M. (2006) *The University and the State. A Study into Global Transformation* (Frankfurt/New York: Peter Lang Scientific).

OECD (2007a) *Education at a Glance: OECD Indicators* (Paris: OECD).

OECD (2007b) *OECD Reviews of Tertiary Education – Poland* (Paris: OECD).

OECD (2008) *Education at a Glance 2008: OECD Indicators* (Paris: OECD).

Parsons, T. (1964) *Social Structure and Personality* (London: The Free Press).

Quaißer, G. (2007) "Privatisation of Education. Some Hints on the Driving Forces", *Der Öffentliche Sektor – Forschungsmemoranden*, Vol. 33, No. 4, pp. 31–38.
Toliou, R. (2007) "Neoliberal Policy and Higher Education in Europe: The Case of Greece", *Der Öffentliche Sektor – The Public Sector*, Vol. 33, No. 3, pp. 51–58.
Vibro, A. (2007) *Research Intensive Universities: On Limits and Possibilities in the Nordic Countries* (Paper presented at the CHER Annual Conference).
Zgaga, P. (2007) "University Mission Between Searching for Truth and Commercialization", *Der Öffentliche Sektor – The Public Sector*, Vol. 33, No. 3, pp. 25–32.

11
Privatisation of Pensions

Miren Etxezarreta and Mejra Festic

11.1 Introduction

In economic policy, as in science, there are periods of change in paradigm, and other periods in which normal science develops, with gradual changes within the new paradigm (Kuhn, 1962). In 1994, the World Bank published its famous report 'Averting the old age crisis' about its view of the problems of public pensions, that led to a period of strong 'paradigm' change about policy related to public pensions in the whole world.

That period, broadly the decade of the nineties, was followed by another period of 'normal science/policy' (in Kuhn terms) during which many developments are taking place but without main alterations, rather being implementations *within* the frame of the previous decade according to the understanding of different countries.

Therefore, in Section 11.2 of this chapter the change in paradigm about pensions that has taken place mainly during the 1990s is reviewed, in Section 11.3, the consolidation of those changes and further significant developments both at the EU and member country levels are dealt with. Section 11.4 deals with some problems of private pensions, and Section 11.5 with social reactions. Section 11.6 concludes the chapter.

11.2 The change of paradigm about public pensions

11.2.1 The crisis of the public pension systems

A particularly important area of neoliberal counter-reform of the last thirty years is the pressure for the so-called modernisation of social security systems. The essence of this is the intention to weaken the public provision of pensions and to prove the usefulness of privatisation, mainly under the argument of the economic unsustainability of the present systems, which require increasing amounts of financial resources.

A very important aspect of that 'modernisation' is the issue of the 'crisis of the pension systems'. Launched in 1994 the report of the World Bank,

mentioned above, may be considered as the 'official' starting point of the present debate, even if already in the seventies substantial pension reforms had taken place in Latin America. Using an ambiguous mixture of arguments about the need to modernise the pension system and the implicit suggestion that privatisation will solve the financial problem, the alleged 'crisis of the pension system' and the need for pension reform was declared.

The arguments of the reformers are presented as unavoidable due to the changes in the demography – 'the demographic threat' – and the labour market. It is asserted that the increasing number of elderly people will lead to a situation when sometime in the future (10, 20, 30 or more years according to different studies) the public pension system will become financially unsustainable. More so, if the new features of the labour market are considered, since the demographic dependency ratio will increase from the existing 25.4 per cent to 50.4 per cent in 2050 (Mencinger, 2008), and a decreasing number of the working population will have to sustain a growing number of old people. Therefore they will become discouraged to work. It is also alleged that private pension systems are more efficient than public financing of pensions due to the higher returns of the stock market over wages and the advantages of competition, that public expenditure will diminish since it will not have to cater for pensions or make up for the deficit of the public pension systems and especially, it is asserted that private funding of the pension system would increase total savings and foster economic growth.[1] It is equally argued that the only sound system is the actuarial one when everybody receives at most what he/she paid avoiding the solidarity links of public systems.

To counter this foreseen crisis two lines of action have been recommended:

- *To diminish the benefits of the public system*. Proposals are made for raising retirement age, longer working life, more years of contributions (or taking into account the contributions of the full working life) to qualify for basic entitlement or for a full pension, and penalties for earlier retirement. The deterioration of the public schemes is also considered a good way to induce people to subscribe to privately funded systems.
- *To develop private pension systems*. It is argued that future retirees would be better off investing at least part of their savings in private, funded pension plans which must function through capital markets. Only the very poor should be entitled to public provision of pensions. This trend towards privatisation should be supported with important tax incentives for savings going to private pension funds.

An important additional element of great relevance embedded in the pension reforms is the increasing transformation of defined benefit systems into defined contribution ones. Although both systems may coexist, most of the old public pension funds were defined benefit and often 'modernisation'

of pension systems implies a transformation of defined benefit funds into defined contribution regimes, which are associated with capitalisation and therefore are risky systems for retirees.

The overall purpose of the proposals is to substitute partly or totally the present public system (pay as you go, PAYG) by a private insurance system run on capitalisation of individual savings on an actuarial basis.

The authorities of the European Union (EU) seem to have accepted the soundness of the arguments for 'modernisation' and privatisation of the social systems, since their guidelines for social policy unambiguously recommend privatisation. The development of social policy along these trends has been and is one of the priorities of the EU agenda.

11.2.2 A critical appraisal of the arguments for reform

The arguments presented above correspond to a very specific economic and social analysis which may be, and has been, widely contested. They can easily be refuted theoretically and empirically, and it can be shown that private pension systems do not lead to a better system for pensioners nor for the economy of the countries concerned.

While demographic changes raise problems and require political responses to ensure financial sustainability, they do not justify alarmist scenarios of a breakdown of such systems due to the following reasons: Demographic projections differ considerably depending on their basic assumptions and are subject to many unforeseen variables; the relevant element to consider is not the demographic dependency ratio but the economic dependency ratio; the foreseen changes are very similar to what has been observed in the past 45 years;[2] problems of pension financing are not exclusively the results of demographic changes but also of economic growth, of the situation of the labour market and of the distribution of incomes.

The argument of a smaller number of workers having to sustain increasing numbers of old people is also misguided, since the relevant variable is not the number of workers but the wealth and revenues they produce. Since in our societies, fewer workers are producing much more wealth than a greater number of workers in the past, the number of workers is almost irrelevant[3] and the 'problem' becomes one of the distribution of wealth. As for the argument that increased contributions will discourage labour, "available evidence from a survey carried out by the European commission (1993) shows that a majority of European citizens would support these social transfers" (Concialdi, quoted in Huffschmid, 2005, p. 74). "Therefore the central question is not demographic…but the overall issue is distributional: how do our mature industrialized societies distribute produced wealth and revenues" (Dräger, quoted in Huffschmid, 2005, p. 75).

Mencinger (2008) summarizes the determinants of the European pension systems with a regression equation, in which the share of pensions in Gross Domestic Product (GDP) is the dependent variable. The results of his regression

prompt him to affirm that "the threats of 'greedy pensioners' for the fiscal balances of New Member States (NMS)s are highly exaggerated" (p. 7).

The reality of the crisis is rather dubious, the consequences of the decreasing number of workers fallacious and the postulated reaction of workers to increased contributions unjustified.

With regard to the proposed solutions brought forward by the advocates of the reform the following critical points should be made:

The diminishing of benefits of the public system: the proposals mentioned above ignore that often the labour career of individuals does not depend upon their will but on that of their employers and upon the employment situation of the country. For instance, for the increase of retirement age it cannot be ignored that many early pensioners are not so out of their will but because their enterprises compel them to retire. More years of contributions for a full pension present also many problems: actual labour markets with many temporary contracts, self-employed people and long periods of unemployment, together with the expansion of informal work, make it very difficult to complete the number of years required, and the degree of public pension coverage may decline quite significantly. These problems are especially acute for women, many of whom do find great difficulties to cover the required number of years of contributions and are affected disproportionately by increases in the retirement age. It is very likely that replacement rates will diminish. Also, it increases the actuarial character of pensions.[4] On the other hand it does not seem that there is a lack of labour that justifies working longer. Therefore those 'solutions' may imply nothing but to push a problem from one social security scheme to another either because those unable to retire will become unemployed or because poor pensions will have to be complemented with assistance to poverty situations. And the question really is – is it fair to go on diminishing the incomes of old people, leading at least significant numbers of them into economic difficulties and even to poverty?

Mencinger (2008) reviews three directions envisaged by the Commission for possible 'solutions': the demographic renewal (increasing birth rates and migration), the 'Lisbon' direction (the most efficient knowledge-based society of full employment) and the financial direction (budgetary restraint, increase the level of contributions and development of private savings), and concludes that neither of the three "assure or even promise secure incomes for the elderly... [and that] solutions for the ageing of the EU population can be found within the existing PAYG systems" (p. 16).

Developing private systems: Empirical evidence about the consequences of privately funded systems – in Latin America and some EU countries (including some CEECs) – show that they have no comparative advantage against public PAYG systems and in many cases are clearly inferior.[5]

The most important danger of private pensions is that they expose the living standard of future pensioners to the systemic instability and incalculable

risks of financial markets. The recent financial crisis and the collapse of many financial institutions, have impressively demonstrated that these markets are not a reliable basis for safe pensions. Financial institutions have expanded beyond reasonable limits, and been deeply involved in untenable loan policies and irresponsible financial speculation that lead profits to soar as never before, to crash down later taking down with them the assets of pension funds and the savings of millions of old age pensioners. Another element of risk is related to the danger of corruption in big financial and entrepreneurial undertakings, which has been greatly facilitated by deregulation and financialisation.

The macroeconomic viability and advantages of increasingly funded systems are usually exaggerated. In developed countries like the EU, it is probably not the case that (assumed) additional private saving through funded systems into additional capital stocks will increase economic growth. Also, after the transition period of regimes, maturity of pension funds implies that the saving decisions of the young are matched on average, by the dissaving decisions of the old. There is no evidence either that in the long run stock markets produce greater revenues than government bonds.

Public PAYG systems are less costly and more comprehensive in their coverage – concerning for instance periods of unemployment, sickness and disability – than privately funded systems which exacerbate social divides. Private systems do not allow for considerations of solidarity among different social groups or individuals, since they are actuarially based. There is no evidence either that the privatisation of pensions improves the balance of government expenditure, especially if the costs of tax benefits awarded to private pension contributions are considered. For instance a Council of the European Union (CEU) report mentions that estimates provided by member states show that "gross annual costs [for privately managed pension provision] range from 0.5% to 1.5% of GDP" (CEU, 2006, p. 73). Besides, the administrative and management costs of private systems are much higher than those of public systems.

However, shifting public pension systems from public PAYG schemes to privately funded capital market schemes have far-reaching consequences for pensioners.

Since for most of them pensions are an essential part of their total income, financial crises can push many pensioners into sheer poverty. This is not acceptable in a society which assumes responsibility for the social welfare of its citizens.

Privatisation undermines the financial base of the public pension systems and imposes large transition burdens on the public. It leads to a more unequal distribution of pensions between those who could afford additional individual savings during their active lifetimes and those who could not. What will happen to those workers that cannot save for the future?

The reasons which are given to justify the shift from public PAYG schemes to private capital market schema, are not only unconvincing but simply fallacious and have no economic rationale. The current public systems are efficient, less costly, incur in much smaller risks and are more sound financially for the foreseeable future relative to private sector alternatives. The possible changes needed to keep them solvent over the very long term are not larger than changes that have been made in several prior decades.[6]

11.2.3 The real drivers of the reform

"The provision and security of old-age income is not the central objective of the trend towards pension privatisation in the EU" (Wehlau, 2008, p. 1). The thrust of privatisation is the need of financial capital to find ever-increasing fields to obtain profits and increase their power. Therefore, financial institutions intend to make of the delivery of welfare a product that generates profits. Since with privatisation the large institutional investors receive workers private insurance contributions obtaining command over billions of funds to invest on financial markets that may produce large profits and considerable power, they have a major interest in the transformation of public systems in funded private systems. "The financial industry succeeded in developing ties to the policy network and became an influential member of this network itself" (OECD, cited in Wehlau, 2008, p. 4). It is extremely active using its lobbying power leading the drive towards privatisation and transmitting to professional and public opinion the risks of unsustainability of public systems. Cases of lobbying activities and personal connections between the financial industry and politicians are well known. However, the interests of asset managers should not be confounded with social welfare since it offers little obvious benefit to workers, pensioners and citizens.

In spite of all arguments against privatisation, the governments of almost all EU countries – both of old and even more new members[7] – developed strong incentives in favour of defined contribution funds, particularly in those countries where they were absent or negligible. Public pensions suffered a strong setback in most countries and even in those where they were maintained, 'complementary' private schema were stimulated with differences between countries.

The EU authorities have also had a very active role enhancing private systems. Besides their option for neoliberal policies which is at the basis of their privatisation drive, it seems that one of the main real reasons behind the EU favour for private pensions is its aim of creating fully integrated capital markets. The expansion and integration of financial markets require permanent flows of great funds, and private pension plans become very relevant because "funded pensions are often the main source of growth for institutional investors" (OECD, cited in Wehlau, 2008, p. 1).

Overall, private pension systems – often compulsory, sometimes optional – have become during the 1990s a common feature of the pension systems of

the EU and the multi-pillar paradigm has become dominant. It seems the recommendations of the World Bank, the interests of the financial agents and the wish for fully integrated financial markets have completely convinced the governments, the EU and some social agents in favour of privatisation, even if this clearly conflicts with the wishes of important parts of the European populations that are overtly manifesting their rejection to deterioration of the public system.

11.3 Dynamic continuity

11.3.1 The trends for change in the EU

The main overall trend observed in the pension field in the EU at the beginning of the twenty-first century is the continuation of the privatisation drive by the Union and all governments of the member states. Neither the powerful criticism against the arguments to sustain the change towards privatisation nor the important social resistances in many countries, have been able to stop their resolve to increase the privatisation of pensions. Further, by providing a variety of incentives for the private pension market paradoxically state intervention has been central to enhancing private pensions.

The EU has not changed with the transition to a new century. Privatisation is justified as before, and the validity of its previous recommendations and proposed solutions acknowledged. There is only a slight change in emphasis recognizing the value of public pensions: "However, the EU will assert that the pay as you go systems will remain the principal source of income for pensioners and that minimum pensions have to be provided for out of the public system ... the trend towards a broader use of privately managed pension provision does not allow public policy to retreat from the area" (SEC, 2006/304, p. 13). Perhaps it starts to realize the high risk and other difficulties that private pensions present. Nevertheless, in spite of these qualifications the Union keeps promoting the increase of funded private pensions in all member states, while the objective of minimum provisions for old people looks rather like lip exercise for legitimation. *Dynamic continuity* could sum up what is going on in the pension realm.

Besides the paramount interest in increasing the private systems, the main priorities for the immediate EU policy seem to be the ones described below:[8]

- *Restricting the conditions of eligibility, particularly to maintain people working longer:* "The main pension challenge for Europe's ageing society is to ensure that this rise in the effective retirement age continues" (SEC, 2006/304, Full report, p. 3) – strengthening the contribution/benefit link, increased contributions or benefits related to contributions of the whole working life.

- The question of portability of pensions. Even if it is asserted that workers who change employers frequently are better served by statutory schemes, given the increasing importance of private pensions and the greatly increasing labour mobility, the portability of pensions becomes an important element in order to facilitate the mobility of workers.

How may these aims be evaluated?[9]

For the great emphasis placed in the prolongation of working lives, we have already referred above to this issue and shall not elaborate on it further. Only to add if, even with longer life expectations, is it acceptable and fair to pressure seniors to go on working while youngsters find it very difficult to obtain non-precarious jobs?

As for portability, the EU has devoted to this issue two main documents (EC, 2003/41/EC and EU, COM (2007) 603). The first one (2003) dealt with institutions that provide occupational pension services and supervisory procedures of them, aiming at becoming a first step on the way to an European internal market for occupational retirement provision, while the more recent document (2007) is in principle devoted to guaranteeing workers pension schemes especially those supplementary schemes linked to the employment contract. The first draft of this directive was subject to important changes at the reading of the European Parliament and its final version is extremely ambiguous and retains very little operational value for the stated objectives of the original draft, since among many other changes all references to transferability and portability have been eliminated. The portability issue remains still open implying significant disadvantages for pensioners since in some cases it has been found that "By changing jobs six times during a person's working life, between 25–30% of the full service pension is likely to be lost" (Blake, 2003 cited in Walker and Foster, 2006, p. 441).

11.3.2 Western European countries[10]

Pension systems The situation of the pension systems in the EU15 at the beginning of the twenty-first century is summarized in Table 11.1.

Private pensions are widely spread in the Nordic countries (above 90 per cent of the population is covered) and France, middle of the way (between 40–60 per cent) in the continental countries and the UK (with Austria presenting only 35 per cent coverage) and present very low coverage (below 10 per cent) in the southern countries.[11] The place of private pensions in the income of pensioners varies accordingly, with the countries with the highest proportion representing between 20–30 per cent (Netherlands, UK, Sweden, Denmark, Ireland) and much lower percentages for the rest. It appears quite evident that the importance of private pensions depends on the space left by public pensions.

Table 11.1 The different types of pension schemes

Traditional classification	Type of scheme	Examples
Statutory schemes (1st pillar)	Universal flat rate linked to residency	Denmark, Netherlands
	Universal flat rate, funded by social insurance contributions	United Kingdom, Ireland
	Earnings related PAYG (with or without reserve fund)	Most member states including Belgium, Germany, France (Régime général, AGIRC, ARRCO), Finland, United Kingdom (1), Spain, Luxemburg...
	Earnings related, totally funded (by social contributions)	Austria (BMVG) (2), Denmark (ATP, SP and SAP schemes), Sweden (Premium pension), Italy (TFR)
Schemes linked to employment status (2nd pillar)	Mandatory for employer (sectorial or cross-sectorial) or resulting from collective agreement (which makes membership mandatory)	Netherlands (occupational schemes can be mandatory, under certain conditions), Germany (at the request of the employee), France (group insurance based occupational schemes), Denmark (labour market schemes), Sweden, Portugal (occupational schemes can be mandatory under certain conditions)
	Resulting from collective agreement (membership not mandatory)	Belgium (occupational schemes), Germany (occupational schemes), France (PERCO), Italy (occupational schemes), Spain (occupational schemes)

	Contractual or unilateral by employer (including book reserve or group plans)	Germany (deferred compensation), Austria (BBG), Finland (occupational schemes), United Kingdom (occupational schemes), Ireland (voluntary occupational plans), Greece (occupational pension funds)
	Possibility to subscribe to pension scheme through one's employer	United Kingdom (stakeholder and personal pensions), Ireland (RACs and PRSAs)
Schemes based on voluntary individual decisions (3rd pillar)	Voluntary schemes, with individual membership (no employment link is necessary to become member), that can be adhered collectively (for instance through associations or unions)	France (PERP), United Kingdom (stakeholder and personal pensions), Spain (Personal plans)
	Individual contracts with pension funds, life insurance companies or pension savings institutions	This type of individual provision is generally available throughout the European Union

(1) The UK State Second Pension scheme is mandatory, but people can contract out into an occupational or personal pension scheme.
(2) The new severance pay scheme in accordance with the Occupational Retirement Provision Act (BMVG).
Source: CEC (2005), taken from André (2007), p. 3

The weight of expenditure in pensions measured as a percentage of GDP presents a wide range of variations, as could be expected. According to Table 11.2 the average for the EU 27 is 12.1 per cent for 2005 and 11.9 per cent for 2006, the average being also around 12 per cent for EU25 and EU15, but slightly decreasing with the years. The share of most Western countries is above 10 per cent, the highest being Italy (14.7 per cent), Austria (14.0 per cent) and Portugal (13 per cent), with Spain (8.8 per cent) Luxemburg (8.6 per cent), and Ireland (5 per cent) below the 10 per cent line, with the rich outsiders Switzerland (12.7 per cent) and Norway (7.6 per cent) with sensible differences.[12] For the CEE countries, except Poland (12.4 per cent) and Slovenia (10.3 per cent), all of them are below the 10 per cent line. The Czech Republic (8.4 per cent) and most of the others are slightly above 6.0 per cent with Estonia the lowest (6.0 per cent).

An important aspect relates to the evolution studied here between 1995 and 2006. Except for Greece, Czech Republic, Italy, Cyprus, Hungary, Malta, Portugal, Iceland and Switzerland, in most other countries the share of expenditure for pensions in the GDP diminishes, with Germany, Ireland and Slovakia remaining constant. Portugal is the one that increases most (from 9.7 per cent to 13.0 per cent) and Latvia, Spain and Luxembourg the ones in which the shares diminished most. This trend may have opposed evaluations: as a success of the measures taken to limit that expense, or as a worrying feature indicating that old people have to do with a smaller share of social income. But this trend depends also on the evolution of GDP and other measurements should be considered (for instance, growth rate of spending per capita at constant prices).

As it has been stated, several reforms of pension systems have been implemented in the old member states. An initial stream of reforms consisted in restricting the conditions of eligibility and reducing the benefits of public pensions, while the second was based on privatisation under the form of increasing funding schemes.

The falling share of pension spending on GDP has been mentioned above. But the evolution of the average annual growth rate of (public) old age spending[13] per head of population is more significant for assessing the real evolution. Table 11.2 shows that apparently state interventions to limit the increase of spending on *public* pensions seem to have reached their aim as the growth rates have generally slowed down after a turn at the beginning of the 1990s in most cases. Only Germany, United Kingdom and Portugal are exceptions due to specific reasons (unification in Germany for instance).

Several types of incentives were given to private pension funds: not only important tax incentives for private funds have developed but other incentives have been implemented – for instance enhanced liberalisation of investments; but the major public incentive given to pension funds in some countries is the new regulation making them compulsory.

Table 11.2 Share of expenditure for pensions in % of GDP (current prices)

Time geo	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
UE (27 countries)	:	:	:	:	:	:	:	:	:	:	12.1 (p)	11.9 (p)
UE (25 countries)	:	:	:	:	:	12.3	12.2	12.2	12.3	12.2	12.2 (p)	12.0 (p)
UE (15 countries)	12.5	12.7	12.6	12.4	12.4	12.3	12.3	12.3	12.3	12.3	12.3 (p)	12.1 (p)
Euro Zone (15 pays)	:	:	:	:	:	12.5	12.5	12.6	12.7	12.7	12.6 (p)	12.4 (p)
Euro Zone (13 pays)	:	12.9	12.9	12.7	12.7	12.5	12.5	12.7	12.7	12.7	12.6 (p)	12.5 (p)
Euro Zone (12 pays)	12.7	12.9	12.9	12.7	12.7	12.5	12.5	12.7	12.7	12.7	12.6 (p)	12.5 (p)
Belgique	11.8	11.9	11.6	11.5	11.3	11.0	11.1	11.2	11.3	11.2	11.2	11.0
Bulgarie	:	:	:	:	:	:	:	:	:	:	8.0	7.6
République tchèque	7.3	7.5	8.3	8.3	8.5	8.5	8.5	8.8	8.7	8.3	8.4	8.4
Danemark	11.3	11.4	11.1	11.0	10.8	10.5	10.6	10.7	11.1	11.0	11.0	10.6
Allemagne	12.5	12.6	12.7	12.7	12.8	12.9	13.0	13.2	13.4	13.2	13.1	12.7 (p)
Estonie	:	:	:	:	:	6.7	6.0	5.9	5.9	6.0	5.9	6.0
Irlande	5.0	4.7	4.3	4.0	3.8	3.6	3.7	5.0	4.9	5.0	5.0	5.0
Grèce	10.0	10.4	10.5	11.1	11.3	11.1	11.9	11.8	11.6	11.7	11.9	11.9
Espagne	10.1	10.3	10.1	9.9	9.6	9.6	9.3	9.2	9.1	9.0	8.9	8.8 (p)
France	13.4	13.5	13.5	13.4	13.4	12.9	12.9	13.0	13.1	13.1	13.2	13.2 (p)
Italie	14.2	14.5	15.0	14.5	14.9	14.4	14.3	14.6	14.7	14.6	14.7 (p)	14.7 (p)
Chypre	:	:	:	:	:	5.8	5.8	6.5	6.8	6.6	6.8	6.8

Table 11.2 Continued

Time geo	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006
Lettonie	:	:	9.5	10.2	10.8	9.5	8.6	8.2	7.5	6.8	6.3	6.1 (p)
Lituanie	:	6.7	6.7	7.3	8.2	7.8	7.3	7.0	6.8	6.7	6.6	6.4 (p)
Luxembourg	11.1	11.0	11.3	10.9	10.1	9.4	9.8	10.0	10.1	9.9	9.6	8.6
Hongrie	:	:	:	:	9.1	8.4	8.6	8.9	9.1	9.3	9.8	10.0
Malte	7.3	8.1	8.1	8.3	8.4	8.0	8.9	8.6	8.9	9.0	9.2	9.2
Pays-Bas	13.9	13.8	13.4	12.8	12.8	12.5	12.4	12.7	12.8	12.8	12.5	12.7 (p)
Autriche	14.2	14.4	14.4	14.3	14.4	14.3	14.5	14.6	14.8	14.5	14.2	14.0
Pologne	:	:	:	:	:	12.6	13.6	13.7	13.8	13.3	12.7	12.4
Portugal	9.7	9.9	9.9	10.0	10.1	10.5	10.9	11.3	11.8	12.3	12.8	13.0
Roumanie	:	:	:	:	:	6.7 (p)	6.9 (p)	6.8 (p)	6.1 (p)	6.2 (p)	6.2	6.5
Slovénie	:	11.1	11.0	11.1	11.1	11.1	11.2	11.3	10.8	10.5	10.3	10.3 (p)
Slovaquie	7.3	7.2	7.2	7.4	7.5	7.5	7.4	7.4	7.3	7.4	7.5	7.3 (p)
Finlande	12.7	12.7	12.0	11.2	11.0	10.5	10.6	10.9	11.2	11.2	11.2	11.0
Suède	12.5	12.5	12.3	12.1	11.8	11.3	11.4	11.6	12.3	12.3	12.4	12.0 (p)
Royaume-Uni	11.7	11.6	11.7	11.2	11.3	11.9	11.5	10.8	10.6	10.6	10.8	10.7 (p)
Islande	5.7	5.6	5.7	5.7	5.9	6.2	6.1	6.6	7.3	7.1	7.0	6.8
Norvège	8.4	8.1	8.0	8.6	8.7	7.6	7.7	8.4	8.7	8.4	8.0	7.6
Suisse	11.1	11.4	11.7	11.9	12.2	12.0	12.5	12.7	13.1	13.0	13.1	12.7

: = Non disponible, p = Valeur provisoire
Source: http://epp.eurostat.ec.europa.eu/tgm/table.do?tab=table&init=1&plugin=0&language=en&pcode=tps00103

Table 11.3 Average annual growth rate per capita of spending for pensions, at constant price, in %

	1980–2001	1980–1990	1993–2001
Belgium	3.09	2.28	1.84
Netherlands	1.48	2.19	0.18
Germany*	1.54*	1.59*	2.55
France	2.83	2.93	2.03
Austria	2.63	2.87	2.34
Denmark	2.15	2.00	0.70
Sweden	2.49	2.84	0.92
Finland	3.39	5.78	1.55
United Kingdom	3.13	2.01	2.36
Ireland	1.88	1.98	1.50
Italy	3.64	4.72	2.20
Spain	4.18	4.38	2.37
Portugal	7.27	5.31	6.72
Greece	3.98	5.67	5.51

*1993, 2001 including former GDR
Source: André (2004)

Though some uncertainty is present in the disposable data (OECD, 2006), the comparison of the assets of pension funds and of their variations during the beginning of the 2000s allows characterising the countries in the following way:

- in the continental countries, the size of assets of pension funds varies between 3.9 per cent and 5.8 per cent of the GDP in 2005, but in the Netherlands where the pension systems have been built on pension funds for a long time the assets have reached 124.9 per cent. These assets have been growing between 2001 and 2005 in most countries except in Belgium and in France.[14] They strongly increase in the Netherlands.
- in the Nordic countries, there is a wide range of assets in per cent of the GDP in 2005: 14.4 per cent in Sweden, 33.6 per cent in Denmark, and 66.1 per cent in Finland. The ratio increases in all the countries over the period 2001–2005 though it has slightly decreased in 2002.
- in the Anglo-Saxon countries in 2005, the assets accounted for 52.8 per cent of the GDP in Ireland and for 70.1 per cent in the United Kingdom. They relatively decreased in 2002 in both countries and again in 2003 in the UK.

- in the southern countries (except Greece for which there are no data), the assets are limited, with less than 12.9 per cent of the GDP in 2005. They slightly increased between 2001 and 2005.

It is seen that the assets of private pension funds are still very different in the member states. In several countries, they reach quite huge levels. But private pension funds are extremely risky, as shown by the stock exchange crisis at the beginning of the 1990s and the big financial crisis of the present period (2007–2009)[15] and some financial scandals (the Maxwell scandal in the United Kingdom for instance, the recent Madoff scandal in the United States). "It must be noticed that, in 2002, some big English pension funds have even advised to their members to leave them and to subscribe to the complementary public schemes!" (André, 2007, p. 28). The implementation by the state of a new regulation, during the 1990s, trying to prevent some causes of failure reveals today to be totally insufficient for protecting pension benefits. Several pension funds do no more succeed to fulfil the financial criteria imposed by the state for limiting risk, for instance in the Netherlands, and the level of pensions will probably be reduced in the future. This will likely be the case in other countries as well. The magnitude of losses in the next years is still unknown, but pension benefits are at risk to be strongly reduced in countries where private funding is well developed.

We have said previously that a frequent trend in the reforms was a transformation of defined benefit funds into defined contribution funds: In 2004, for private pensions, defined contribution funds are dominant (more than 50 per cent) among occupational plans in Austria, in Denmark, in Ireland, and in three on four of the southern countries. Nevertheless, an important share of schemes continues being defined benefit schemes (Netherlands, United Kingdom). The ratio of defined contribution plans to total plans has reached 25 per cent in Belgium and 22 per cent in the United Kingdom. This ratio is very small (less than 9 per cent) in the Netherlands, in Germany, in Sweden, in Finland and in Portugal. There are also some hybrid types of schemes for which, for instance, a minimum rate of return is guaranteed in a defined contribution scheme (for instance Belgium, Denmark). When personal plans are added the proportions change significantly only for Sweden (41 per cent defined contribution plans and 59 per cent defined benefit schemes) and Finland (20 and 80 per cent). The share of defined contribution schemes tends to increase in Austria, in Sweden, in the United Kingdom and in Italy (André, 2007, table 2, p. 25).[16]

Finally, it seems that the trend to increase funded private pensions is well established:

André (2007) mentions the report (CEC, 2005) that presents some estimates of the future development of private pension schemes, and it shows that although the expected changes differ in their size depending on countries, most of them expect that the importance of private pensions will increase in the contribution of retired persons income.[17]

11.3.3 The CEE countries

Since privatisation and liberalisation had been the instruments of transition into the market economy of the Central and Eastern European countries (CEEC) they went for rapid and wide privatization procedures, giving a heavy weight to the private side of the pension systems. In addition, another major difference with the West was because in the previous system state enterprises were managing the pensions and therefore their privatisation compelled to change the system of pensions as well.

The diagnostic of the problem has been the same as in the old countries:

> It is expected that working age population will decline because of low fertility rates (in the Czech Republic even lower than in the less fertile EU-15 – Italy, Greece, Spain), and life expectancy is supposed to increase significantly.... This fact presents a considerable concern with respect to the economic and social outlook due to higher dependency ratio.... Some factors offset the decline in the benefit ratio, like the decline in the take-up ratio in the EU-10 NMSs. On average, if there are no offsetting factors, demographic pressure would push public pension spending significantly upwards (Festic, 2008, p. 3).

However, Augustinovics (1999) adduces that the demographic phenomenon have not appeared yet on a large scale in post-communist economies, and Mencinger (2008) states that the public pension expenditures and the transfer from active labour force to retired population are not eroding the public finance due to the fact that the quotient of age dependency was stagnating in the period between 1995 and 2005; and even more, the volume of pensions and the growth rate of average pension is lower than the GDP growth, while Hausner "argues that the pension system in the post communist economies can be repaired and radical reform avoided. Rationalizing and regulating the PAYG system would restore long-term financial balance to the system.... At the same time, voluntary savings are low due to relatively low income level of the population in transition economies" (quoted by Festic, 2008, p. 11).

In spite of these arguments, most of the CEE countries reformed their pension systems towards privatisation in the late 1990s or early 2000s. In overall terms, the new systems are based on a mandatory privately funded scheme, compulsory for new entrants to the labour markets and for people below a certain age and voluntarily available to older persons while maintaining the old system for those who did not want or were not obliged to join the new system.

Some data on pensions in the CEE Countries are presented in Table 11.4 and their pension systems may be clustered into three groups:

1. Latvia and Poland, where pensions are financed on PAYG basis but entitlements are worked out in the same way as in private defined contribution pension funds and the pension is an annuity drawn from the

Table 11.4 Pensions in the new member states

	Pension expenditures/ GDP[b]	Average pension/ average gross wage (in %)[a]	Population over 60 (in % of total population)[b, a]	Benefit ratio = average pension/ GDP per worker[c]	Take–up ratio = pensioners/ population(65+)[c]	Dependency ratio = population(+65)/ population(15–64)[c]
Czech Republic	9.4	46	18.2	–9.1	–36.8	109.3
Hungary	9.1	38	19.6	16.3	–33.4	97.4
Poland	13.5	43	16.5	–68.0	–54.5	108.3
Slovakia	7.9	44	15.3	–40.6	–34.0	122.0
Slovenia	14.5	43	19.1	–7.5	–26.8	99.7
Estonia	7.6	29	20.3	–73.1	–26.8	60.3
Latvia	11.4	38	20.6	–40.7	–20.6	62.7
Lithuania	7.3	32	18.5	0.1	–27.3	72.1

[a]2000; [b]average EU–15 = 21.7%, average CEE = 19.2% (2000); [c]2005.
Source: Festic (2008), GVG (2002), DREE (2003) and EC (2003)

accumulated capital sum. The second pillar is compulsory for persons born after 1969 and funded; the contributions for it are transferred to the private pension fund from the accounts maintained with the social insurance contribution.

2. Hungary, Bulgaria, Estonia, Lithuania and Slovakia, where new pension systems have three pillars, the first pillar – the public system – is still a defined benefit scheme, and the second one is compulsory and funded.
3. The Czech Republic, Slovenia and Romania, where the only mandatory system is the PAYG. In the Czech Republic the second tier consists of a voluntary private scheme offering personal pension plans, whereas in Slovenia there are three supplementary pension schemes: a mandatory scheme for formerly privileged branches, a voluntary private scheme for occupational and personal plans, and a pension fund for privatisation certificates (Festic, 2008, p. 7).

The advantages advanced for privatization are the usual ones: higher efficiency, greater savings and enhanced growth, the development of capital markets. As it was to be expected these problems reflect similar problems as those encountered by the old members of the Union even if their incidence may be more acute because of the lower economic and institutional level of these countries. Therefore, the counter arguments, taking into account the circumstances of the European Economic Community (EEC) countries, are

also similar to those signalled above. Specificities of CEE countries reinforce the fragility of privately funded pension systems and the volatility of capital markets due to the novelty and the large riskiness of financial markets and of financial intermediaries, more in a transitional context. Further, the private sector may not provide enough investment projects to efficiently absorb mandated pension savings (Festic, 2008).

11.4 Some problems of private pension systems

The arguments referred to above lead to conclude that 'privatization continued overwhelmingly to worsen the economic and social welfare; and the privatization of pension system would continue to create more *social problems* than it tackled.... The pension privatization is to reduce the welfare role of the state and it could erode collective responsibility for the welfare of the vulnerable (Ginn, 2004). Gender inequality in private pension system and public private mix provisions has implications for pensioner poverty and *distributional outcomes*. The promotion of private pension system enables individuals to compensate for diminishing state pensions and those who cannot do so will face the indignities of means testing and the uncertainties of relying on family members for financial support. Hyde et al. (2003) argue that privatization of pensions allows less scope for expressing the values of social cohesion, integration and inclusion. In state pension provision, minimum or flat-rate pensions and those based on earnings years help women to obtain an independent pension.... In the private system membership of defined benefit occupational pensions is often unequally available to employees. Women's lower coverage than men reflects this as well as their lower employment rate. Part-timers often can not afford the higher contributions required in the employer's pension scheme. Shorter working hours and gaps in employment result in lower pension entitlements relative to men (Ginn, 2004).... The current stampede towards privatization and capital funding is not the solution but will bring a further exacerbation of the real problems of social welfare in a democratic society (Festic, 2008).

As private systems develop, a number of problems crop up showing that they also present serious shortcomings. We shall only mention a few of the most conspicuous: One of the complaints of financial institutions, many governments and especially of the Union about private pensions is the weakness of response to the voluntary private schemas. Contradictory policy measures have caused duplication of regimes and confusion of would-be private undertakers instead of their expansion, increasing inequality is caused because poor people cannot afford private schemes, tax incentives are expensive, non distributive and regressive. Also the 'mis-selling' – tricky sales practices of insurance age for whom commission payments made up a large proportion of their salary – has caused problems and led to an increase of regulatory norms implying the bringing back of the state, and so on and

so forth. Many other aspects affect the operation of funded provision and the obvious conclusion has to be reached that private schemes in practice are not as favourable as their proponents sustain, and that privatisation is not the panacea some people wish believe it is. The present financial crisis strongly reinforces the critical approach to private pensions because it very clearly shows the big risk that the stock exchanges represent to the value of the assets of pensioners.

11.5 The social reaction

In relation to the influence of other social agents – besides political and financial institutions – in the privatisation of pensions, two aspects need to be revised. First, their role in the privatisation process as representatives of pension stakeholders may be worth considering, especially the role of trade unions; and second, the reaction of social agents to the reforms implemented.

The problems that pension reform entails for unions between the interests of current pensioners and those of workers as well as the consequences for funds, and the institutional context of unions, are likely to shape the way the problem is resolved. If trade unions consider that changes are necessary or merely more convenient for their interests, or when unions take part in the reform and in the future management of pensions, they are more likely to accept the reforms, diminishing possible social unrest. Because of this, significant differences among the reaction of unions to the privatisation of pensions may be found: in some countries unions have strongly reacted against privatisation – Greece, Austria and Spain in the eighties – while in others, unions may be considered very complacent and even part of the trend towards privatisation of the financial agents and governments, as in the UK and Spain since the nineties.

As for reactions in front of the implemented reforms, labour unions and other social movements have not been passive in the face of these developments. On the one hand, popular resistance has manifested when specific reforms were proposed in some countries – at least in France, Spain, Italy, Austria, and Greece – and some preoccupation may be detected in public opinion. However, those popular reactions have been milder than could have been expected. We live in a period of very weak unionisation and of strong integration of some leaderships into orthodox thinking and policy. Therefore many unions have accepted rather uncritically the analysis and solutions offered by the establishment considering them as the 'lesser evil'; others have even taken financial advantage of the privatisation of pensions, thus weakening significantly the opposition to it. As for other social movements, it seems pensions are not among their highest priorities, except for some pensioner associations that struggle to improve their pensions. The impact on the populations of the sophisticated and expensive publicity

campaigns financed by banks about the crisis of the public pensions and the advantages of private ones should not be ignored either. We cannot inquire here the reasons for it, but in spite of some sort of generalised social preoccupation for what are presented as the financial difficulties of future pensions, acceptance of the 'inevitability' of private pensions increases and social resistance weakens.

11.6 Conclusions

The pension regimes in the EU at the beginning of the twenty-first century show a continuation of the trends established in the 1990s, stressing permanently the concern for the financial viability of the system, the need to limit the expense on public pensions and the value of developing private pension systems with special reference to a funded mandatory second pillar, completing or replacing the public systems.

As for reforms in the member states, the Union considers that since the 2003 Joint Report: "There has been substantial progress in reforming pension systems.... Disincentives to work longer have been reduced and incentives strengthened, links between contributions and benefits have been tightened and life expectancy has been further taken into account in pension systems. Moreover, the provision of supplementary pensions has been promoted and legislative frameworks improved. Furthermore, some Member States have also tackled old age poverty by increasing the levels of guaranteed minimum pensions.... Reforms have made steps regarding all three key objectives: providing adequate retirement income, ensuring financial sustainability and adapting systems to changing labour market and societal conditions" (SEC (2006) 1247, p. 6/7).

In spite of all these reforms "In order to indicate the relative importance of the risks to the long-term sustainability of public finances, a three level categorisation is used, introduced by the Commission and the Council in the 2005/06 round of assessment of the stability and convergence programmes: low / medium / high risk. Overall, among the 25 Member States of the EU six countries are assessed to be at high risk, ten at medium risk and nine at low risk, which overall confirms the assessments of the stability and convergence programmes carried out in the early months of 2006." Countries were classified as follows: The high-risk group of countries (CZ, EL, CY, HU, PT and SI), the intermediate group of countries (BE, DE, ES, FR, IE, IT, LU, MT, SK and UK) and the low-risk countries (DK, EE, LV, LT, NL, AT, PL, FI and SE) (SEC (2006) 1247, p. 6/7).

To maintain the financial viability of public pensions a series of measures are proposed to limit the benefits and expenditure of public pensions and increase the actuarial character of pension entitlements. Policymakers seem much more preoccupied by the alleged financial unsustainability of the public pension schemes than for the well-being of pensioners. These

measures inevitably lead to decreasing replacement rates; a fact that is fully recognised and accepted by the policymakers. Very little interest is shown in devising specific arrangements to secure minimum pensions, let alone sufficient pension for a dignified life in old age.

The interest in the portability of private pensions is recognised as a very important measure to ensure labour mobility, but policy approaches to enhance it seem rather confused.

The expansion of private pensions are also exposing a set of new problems. Besides, the very high risk that they imply, which is often ignored by policy-makers, inequality, the weakness of response to voluntary private schemas, mis-selling practices and others that require renewed regulatory measures bringing the state back, all show that privatisation of pensions is not the panacea.

Even with the known notable differences among the EU countries, the problems and the evolution that the pension systems encounter, both for public and private systems and for old and new members of the Union, are very similar, even if their incidence in the new countries may be more acute because of the lower economic level and new institutional market frame.

In spite of some social resistance to pension reforms, it does not seem that the latter are encountering the fierce social resistance that may have been expected. For different reasons social leaders and public opinion seem to have accepted the 'inevitability' of the decrease in public pensions and the need for private ones. It seems clear that the outlook is rather grim for public pensions and especially for poor and low-income pensioners.

Notes

1. This argument already existed well before the transition to the market system of the Eastern countries started, but has been widely used since 1989 in relation with these countries because of the need to enhance rapidly the private accumulation process.
2. Between 1960 and 2005, the increase in the share of old age people in the total population of EU25 was 1.1 per cent a year and it should be 1.3 per cent a year between 2005 and 2050. The demographic transition began two centuries ago and will probably come to a standstill (Concialdi, 2006, p. 307).
3. Except if it is assumed that the financing of public pensions depends solely on the number of workers, as it is done by the proponents of privatisation of pensions, which is a totally unjustified assumption.
4. Which among other things implies that with defined contributions a longer life means smaller benefits per year.
5. As an example, see the article *'La crise boursière fragilise les regimes de retraite des Britaniques'* in Le Monde 29 November 2008.
6. In the USA, according to the Social Securities Trustees Report (SSTR): "the tax increases that would be needed to keep the program fully solvent over its seventy five year planning period are comparable in size to the tax increases that were implemented in each of the decades from the fifties to the eighties ... measured as a percentage of taxable payroll ... is 1.92 percentage points. By comparison, the tax was increased 2.24 % points in the eighties (4.4% for the self employed), 1.76 % in the seventies, 2.4% in the sixties and 3.0% in the fifties" (Baker, 2003, p. 2).

7. Even when they were not members yet, they had been more heavily oriented towards privatisation through the general transformation of their countries and the heavy influence of the World Bank.
8. We cannot review here the abundant literature of the Union about pensions but to present a very sketchy summary of the main priorities for change in the recent period.
9. Since policies are similar to the previous period, much of the evaluation we have advanced in Part I applies also here.
10. This part has been drafted relying heavily on various articles by Christine André on social services and pensions, particularly her comprehensive article: *Privatization and pension systems in Western Europe* and with her assistance, for which we are very grateful.
11. There are some differences depending on if the individual plans are or not included but not too significant, except in the case of Spain, where individual plans change the percentage from 10 per cent for occupational to 40 per cent if individual plans are included.
12. This, together with the figures for Ireland and Iceland (6.8 per cent), make it difficult to advance even an hypothesis about the relationship between the expenditure on pensions and the level of economic income or economic growth.
13. Eurostat data, which are used here, cover mainly public spending and include some limited part of private spending but in an irregular and incomplete way for 1980–2001. The new Eurostat data are used from 2005: they clearly include a larger part of private spending for several countries. So, data used for 1980–2001 can be considered as a rough approximation of public spending, while those used for 2005 are an approximation of total spending.
14. It increased in France until 2003 then it has decreased.
15. As an example it can be mentioned that the British Pension Protection Fund, a public body that guarantees 7800 defined benefit plans has asserted in its November 2008 report, that 6468 of them are in deficit and that it has multiplied by four since October 2007 (*La crise boursière fragilise le srégimes de retraite des britaniques*. Le Monde 29 November 2008).
16. There is no information at all for France, and information is lacking for quite a number of countries for personal plans (André, 2007, table 2).
17. See the excellent article by C. André (André, 2007) to have a view of the changes in the European Union countries.

References

André, C. (2004) *Les transformations contemporaines des politiques de santé en Europe* (Rapport CEPREMAP pour le Commissariat Général du Plan, November).

André, C. (2007) *Privatization and Pension Systems in Western Europe* (Paper Presented at the PRESOM Working Group: Privatisation, Health and Pensions).

Augustinovics, M. (1999) Pension Systems and Reforms in the Transition Economies, *ONU CEE Economic Survey of Europe*, 1999, No. 3, chapter 4.

BACA (2007) *Overview of Taxes, Incidental Wage Cost, Pension Systems in the NMS-5*, http://economicresearch-e.ba-ca.com

CEU (2006) Commission of the European Union, See bibliography: EU.

CEU *Joint Report on Social Protection and Social Inclusion 2006* COM (2006) 62 final of 13 February, p. 73.

Concialdi, P. (2006) "Demography, the Cost of Pensions and the Move to Pension Funds", *Review of Political Economy,* Vol. 18, No. 3, July, pp. 301–315.
European Commission (EC) (2003a) *The Social Situation in the EU,* http://ec.europa.eu/employment_social/publications/2003/keag03001_en.html
European Commission (EC) (2003b) *Directive 2003/41 on Portability of Occupational Retirement Provisions.*
European Commission (EC) (2006) *Annexes to the Joint Report on Social Protection and Social Inclusion 2006. Synthesis Report on Adequate and Sustainable Pensions*, Commission Staff Working Document (SEC (2006) 304/COM (2006) 62 final).
European Union (EU) (2003) *The 2003 Joint Report by the Commission and the Council on Adequate and Sustainable Pensions* (7165/03 of 10 March).
European Union (EU) (2006) *Joint Report on Social Protection and Social Inclusion 2006, 2007,* 2008 (COM (2006) 62 final of 13 February 2006, & 6694/07 of 23 February 2007 & 7274/08 of 4 March 2008).
European Union (EU) (2007) *Proposal for a Directive on the Minimum Requirements for Enhancing Worker Mobility by Improving the Acquisition and Preservation of Supplementary Pension Rights* (COM(2007)603 final of 9 October 2007).
Eurostat series *Social Benefits.*
Festic, Mejra (2008) *The Perspective of Pension System Reforms in the New Member States* (Paper Presented at the PRESOM Workshop on Privatisation, March, Rome).
Ginn, Jay (2004) "European Pension Privatization: Taking Account of Gender", *Social Policy and Society,* Vol. 3, No. 2, pp. 123–134.
Huffschmid, J. (ed.) (2005) "The 'Modernization' of Social Policy: A Critique of Pension Reforms" in Huffschmid, J. (ed.), *Economic Policy for a Social Europe* (Basingstoke: Palgrave).
Hyde, M., Dixon, J. and Drover, G. (2003) "Welfare Retrenchment or Collective Responsibility? The Privatization of Public Pensions in Western Europe", *Social Policy and Society*, Vol. 2, No. 3, pp. 189–198.
Kuhn, T. (1962) *The Structure of Scientific Revolutions* (Chicago, IL: University of Chicago Press).
Mencinger, Jozep (2008) *Do Pensioners Endanger Fiscal Stability in the EU Countries?* (Paper presented at the PRESOM Workshop in Privatisation, Brussels).
OECD (2006) Pension Markets in Focus, Directorate for Financial and Enterprise Affairs, No. 3, October.
SEC 2006/304 Commission Staff Working document. See amended bibliography: EC SEC: Commission Staff Working document. *Annexes to the Joint Report on Social Protection and Social Inclusion 2006. Synthesis report on adequate and sustainable pensions,* SEC (2006) 304/COM (2006) 62 final, p.13.
Walker, A. and Foster, L. (2006) "Caught Between Virtue and Ideological Necessity. A Century of Pension Policies in the UK", *Review of Political Economy,* Vol. 18, No. 3, July, pp. 427–448.
Wehlau, D. (2008) *Lobbying for Pension Reform* (Paper presented at the 14th workshop on Alternative Economic Policy in Europe, 26–28 September, Brussels),
World Bank (1994) Averting the Old Age Crisis: Policies to Protect the Old and Promote Growth (Washington, DC: World Bank).

12
Bank Liberalisation and Privatisation

Marica Frangakis, Jörg Huffschmid and Joze Mencinger

12.1 Introduction

Banks used to be the financial backbone for the development of modern capitalism and they continue to be one of the major economic pillars for every society based on large-scale division of labour and the use of money as accounting unit, means of payments, credit and store of value. Banks are the basis of the universal payment system and serve as infrastructure and medium for social interaction and cohesion; they provide credit which is at the centre of capitalist expansion. Instability of the banking system can lead to financial crises which impair the functioning of the whole economy. Therefore the stability of the banking sector is a public good. Lastly, the control over the banking system gives power to influence the direction of economic and social development. All this explains the relatively large role of public ownership and regulation in the banking sector throughout the world in the years preceding the wave of liberalisation and privatisation after 1980.

However, during the last three decades the exclusive role of banks as the financial backbone of modern capitalism has been gradually eroded. Today, we instead have two-pillar systems in most developed countries. In addition to the bank sector, the securities-based financial systems (bonds and equity) play an increasing role in the financing of economic activity. This sector is much more market orientated and much less regulated than the banking sector. Its emergence is a result of the internationalisation of capitalism and the deregulatory tendencies which were gaining ground since the late 1970s and became dominant during the 1990s.

The structure and operations of banks have not remained unaffected by these tendencies. Since the 1980s, a great number of liberalisation and deregulatory measures were taken and throughout the 1990s privatisations occurred in different forms. They took place, on the one hand, in the member states of the 'old' EU15, and, on the other hand – under the completely different overall conditions of systemic transformation – in the new member

states in Central and Eastern Europe (CEE).These changes of bank structures in both parts of the EU are the subject of the present chapter (which does not discuss the securities' side as the second pillar of modern financial systems). In Section 12.2 we briefly present the structure of European banking systems before the reform. Section 12.3 deals with bank liberalisation, deregulation and privatisation in the EU15, and Section 12.4 with the corresponding events in the CEEC. Section 12.5 concludes and gives an outlook on the potential impact of the recent worldwide financial crisis upon the banking sector in the EU.

12.2 Complex and diverse systems: Banking structures and regulation in Europe before the 1980s

Before 1945: The rise and fall of universal banking Banking in Europe started with private initiatives by merchants to facilitate their national and international expansion (see Kindleberger, 1984; Pohl, 1993). Later political authorities assumed a role as guarantor of the stability and validity of the money issued by private banks. A further milestone was the set up of national central banks as either private or state-owned institutions to which the issue of money and the control of financial stability was conferred by national legislation. This two-tier structure – central banks and commercial banks – was firmly established as a basic feature in almost all European countries before 1945.

The development of European banking systems was driven by the growth and expansion of large commercial banks which financed states and the expansion of national enterprises (See Pohl, 1993, CII and CIII). Most of them were universal banks in the sense that there were no legal limits for the regional or sectoral scope of their activities. In the nineteenth century two additional layers of the banking system emerged: first, a system of credit unions, in which the members provided money to each other on a basis of mutuality – mostly in agriculture and housing; second, public or semi-public savings banks with the aim to promote individual savings and extend credit to savers.

Following the worldwide financial crash in 1929–1931 the US government, and later also European countries, introduced a comprehensive network of structural and conduct rules and restrictions for the financial sector to avoid further financial crises. Such rules included strict separation of different business activities and regional reach (Glass-Steagall Act of 1933), interest rate ceilings, limits for fees and commissions, quotas for loans and so on. (see James, 1993, pp. 354–356; Russell, 2008, chapter 4). As a result of these developments the banking sector in most EU countries (and in the USA) was among the most tightly regulated sectors in the respective economies.

Thus, before the division of Europe in East and West rather complex, highly segmented, strongly regulated and diverse banking structures were

in place in most countries. Four pillars could be distinguished which coexisted and were regulated in different ways:

- a national central bank (mostly state-owned, always state-controlled),
- private profit-oriented commercial banks,
- public or semi-public not-for-profit savings banks with limited regional reach and public interest orientation,
- private not-for-profit credit cooperatives.

After 1945: Different developments of banking in East and West As a consequence of the division of Europe after the war the banking systems developed in completely different ways.

In *Western Europe* the complex and segmented banking landscape was largely maintained. Regulation was even intensified and nationalisation of private banks, which had started on a large-scale basis in Italy already before the war, was considerably extended. In France, four leading commercial banks were nationalised in 1945 as a means to gain control over the direction of economic development in the framework of French *planification*. The UK government nationalised the Bank of England in 1946. In Portugal, all major commercial banks were nationalised after the collapse of the Salazar regime in 1973, and in Greece the same happened after the short period of fascism in the mid 1970s. At the beginning of the 1980s the state owned more than 60 per cent of all bank assets in France, Italy, Portugal and Greece, and in Germany, Sweden and Belgium the share was higher than 20 per cent (de la Motte, 2007, p. 3).

Several justifications for this were brought forward which in their entirety reflect the conception of an active, interventionist and social function of the state in finance (see Andrews, 2005, pp. 6–7; Megginson, 2005, pp. 1992–1993):

- Stimulating growth when economic institutions are not sufficiently developed for private banks to meet the financing needs of the economy. This is the so-called development view of state-owned banks.
- Controlling the 'commanding heights', that is strategic sectors of the economy, ensuring that the growth of regions and/or sectors is not impeded by market failures. This is a variant of the 'development view', applying mainly to developed countries.
- Bridging the gap between principal (the public) and agent (the producer), in the case of significant informational asymmetries where complete contracts cannot be written and enforced.
- Ensuring the stability of the financial system by means of overseeing the banking system and, in the case of a crisis, taking the necessary measures to alleviate its implications for the economy at large, such as lender-of-last-resort operations. This is usually the function of a central bank.

- Pursuing social goals, such as providing finance to poorer borrowers who would be neglected by less informed or motivated private bankers; supporting employment and reducing income inequality in any particular region or sector. This has been called the 'political view' of state-owned banks.

In *Eastern Europe* the traditional banking structures were completely broken up after the war (Barisitz, 2008, chapter 3). The whole sector was nationalised and integrated with the monetary branch into the state planning system. The two-tier system was abolished and replaced by a monobank structure. All monetary and credit functions were centralised in one monetary authority with different branches for different purposes: to finance production, investment, and foreign trade, to collect individual savings, to organise the issue of cash money, and the payment system.

The most important difference with regard to the Western system was the fact that commercial banks lost the credit creation capacity which had made them active drivers of capitalist expansion, innovation, and permanent restructuring. In Eastern Europe capital markets, where they had began to emerge, were abolished, and so were genuine credit markets.

12.3 Financial liberalisation, deregulation and bank privatisation in the EU15

The main thrust: Deregulation in a single market with a restrictive macroeconomic framework Financial liberalisation became an issue in Western Europe as a result of the globalisation of the international financial system, which was largely the outcome of the internationalisation and deregulation of the US financial system (see Grahl, 1997, chapter 9). In Europe financial integration was regarded as an essential pillar of the Single European Market (SEA) project which was codified in the European Single Act of 1986 and envisaged the transition from a positive integration strategy to a negative integration strategy, that is to market opening with no or very little prior harmonisation of rules. The SEA was followed by the 1988 Council directive on the liberalisation of capital controls and the 1989 Second Banking Directive and several legal acts going in the same direction. During the 1990s, financial deregulation became firmly established in the European agenda. It took place in different forms, in different intensities and speeds in different countries, most sweepingly in Margaret Thatcher's 'Big Bang' reform in 1986 an in Spain in the late 1980s.[1] A further powerful push in the same direction came through the Financial Services Action plan (1999–2005) which included some 40 measures to promote financial integration, mostly through deregulation.

In parallel to this deregulatory dynamic, the EU developed a very restrictive macroeconomic policy framework. For fiscal policies narrow limits for

public deficits of member states were imposed in the Maastricht Treaty of 1992, and reinforced in the Stability and Growth Pact of 1997, while on the European level the volume of the EU budget was kept extremely low and incurring public debt was prohibited. The creation of a single currency and the Monetary Union (MU) in 1999 for 11 member states with the European Central Bank established a European monetary policy regime which was exclusively concerned with price stability and did not bear responsibility for growth, employment, financial market or exchange rates stability. At the same time, while national central banks were deprived of monetary sovereignty, the task of banking and financial market supervision and control was left with the member states. The lack of a common regulatory framework – beyond exchange of information and 'best practices' in numerous committees – for financial supervision and stabilisation in an environment of advanced financial integration made member states – and the EU as a whole – very vulnerable to financial shock, turbulence and crisis. The financial crash of 2007/2008 has demonstrated the weakness of a purely competition-driven financial integration very clearly.

The rationale for privatisation Although privatisation of state-owned banks was not part of the official EU agenda, the thrust on liberalisation, market opening, deregulation and creating undistorted competition had of course consequences for the privatisation issue. State-owned commercial banks and savings banks, operating in a broader social context by comparison to privately owned banks, as well as serving a multiplicity of goals, found themselves under increasing pressure, economic, political, as well as ideological. Liberalisation, deregulation and exposure to unrestricted competition meant for public banks that they should behave like private ones, and this would deprive them of the specific features and orientations which are the essence of their public good character.

In practice, the transition from a state-owned bank with a special public interest mission to a private commercial bank has been a gradual and continuous process. A good example is Italy. The Amato law of 1990 encouraged public savings banks to reorganise themselves as stock companies, the equity of which is held by foundations which still have to fulfil public interest tasks. The provision that these foundations should at least hold 51 per cent of the capital of the stock companies, was abolished through the Dini law in 1994; and in 1998 the Ciampi laws obliged the foundations to sell the majority of their shares in the bank. Today the foundations are still there and they still have to spend parts of the profits they receive for public purposes. But their role as minority shareholders is practically negligible. This is how the Uni Credito Group developed, which is now one of the largest private banks in Europe. In Spain, cooperative banks formed the central private bank Argentaria which was subsequently merged with Banco Bilbao Vizcaya (BBV) to BBVA, the second largest Spanish bank.

In general, most EU countries readily adopted privatisation policies in pursuing a multiplicity of objectives, including (i) promoting efficiency both in terms of improvements in internal efficiency (cost-minimisation) and allocative efficiency (pricing according to marginal cost); (ii) increasing competition in particular sectors and in the economy at large; (iii) developing a national capital market; (iv) reducing the public debt, as well as the public deficit, especially in view of the adoption of the single currency; and (v) last but not least, promoting a culture of equity ownership amongst the population in general (see Frangakis, 2007, p. 1; Megginson, 2005, pp. 1936–1937).

On a more theoretical perspective, public choice theory challenges the assumption of well-informed government agents pursuing social goals, postulating instead that "government actors are politicians and bureaucrats who may be motivated to use state-ownership to secure political office, accumulate power or seek rents" (Clarke et al., 2005, p. 4). Or, more plainly put, "rather than exerting a 'helping hand' to ease market failures, governments may instead use a 'grabbing hand' to satisfy political objectives" (Levine, 2003, p. 12). Therefore, reducing the state-ownership of banks is expected to increase competition and promote efficiency not only in the banking sector, but also in the economy at large.[2]

Such a theoretical approach to bank privatisations has given rise to a pro-privatisation culture, which rests more on ideological preferences than on analytically or empirically proven facts.[3] This is all the more so, to the extent that no causal link has been empirically established between the state-ownership of banks and slower economic growth. The following statement by Andrews (2005), in a Working Paper published by the International Monetary Fund (IMF), is telling in this respect:

> While there may not be conclusive empirical evidence of causations, it is clear that state owned banks are associated with 'bad' growth and development outcomes. These can be attributed to inefficiency on the part of state owned banks or less benignly to political interference. Even if lacking empirical proof, many policy makers have concluded that private sector banks are more efficient and privatisation removes the irresistible cookie-jar of state owned bank largess from the reach of politicians. Thus, the trend to privatisation of state owned banks is likely to continue (ibid., p. 17).

Similarly, although an often-quoted study by La Porta, Lopez-de-Silanes and Shleifer (2002) found, in an examination of 92 countries, that slower economic growth is associated with higher levels of historical state-ownership of the banking system, no causal link between the two could be established.

Based on the above presumptions, a number of recommendations are further made by pro-privatisation analysts (see Clarke et al., 2005; Megginson, 2005):

- The full privatisation of a state-owned bank, as opposed to a partial one, is to be preferred.
- After privatisation, the culture and propensity to lend to state-owned enterprises should be eliminated.
- Sales to foreign owners are to be emphasized. In particular, where the institutional framework of a country is weak, foreigners are to be preferred because of regulation in their home country.
- Sales to one or a few strategic buyers are associated with greater gains, as opposed to a large number of owners through share issue privatisation, due to agency problems.

The theoretical tenets, on which the prevalent orthodox analysis of bank privatisations rests, can be criticized on ideological, political and economic grounds.

- From the point of view of ideology, they reveal a preference for private ownership, which is however argued in economic terms.
- On the level of economic analysis, they arbitrarily assume away the market failures and bank crises that have historically often led to state bank ownership.
- On the political level, they presume that politicians are by nature susceptible to corruption, so that they should be insulated from the exercise of the very powers, for which they are elected into government. Apart from the fact that corruption has become known as a common feature in large private corporations during the last decade, public choice theorists underestimate democracy, which is however universally considered a precondition for economic and social development.[4]

Overall, the rationale for bank privatisations is embedded in an analytical framework, which assumes that for banks to contribute to greater competition and efficiency, and by extension to growth and development, they should better not be publicly owned. This is a circular type of logic, which either ignores or subsumes all other types of influences to its core argument. In spite of the criticism of its weak empirical and theoretical foundations, this approach is prevalent amongst orthodox economists, and it has had most influence on the real process.

The course of bank privatisation As Figure 12.1 shows, bank privatisation in the EU15 was mainly a matter of the 1990s. Altogether, Privatisation

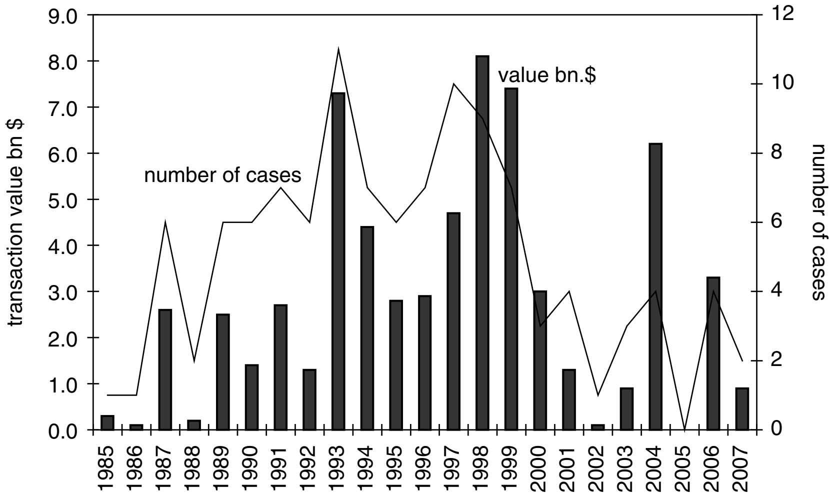


Figure 12.1 Bank privatisations in the EU15, 1985–2007
Source: Privatization Barometer Database; author's calculations

Barometer counts 113 cases with a total value of $64 billion between 1985 and 2007. Of these two-thirds occurred in the 1990s and less than a quarter in the eight years from 2000 to 2007. The number of cases started to rise in the late 1980s and remained high until 1997, when it began to fall steeply until 2002. Between 2000 and 2007 there was no year with more than four cases of bank privatisation. With regard to the transaction value, the process is even more concentrated on five years in the 1990s and one year afterwards (2004, with the privatisation of the French group Eulia and the German Postbank).

With regard to regional distribution, too, bank privatisation was highly concentrated. Almost two thirds (63 per cent), of the transaction value in bank privatisation fell on three countries: Italy, France and Germany (see Figure 12.2).

International comparisons In order to make international comparisons in the area of bank privatisations, we calculated summary statistics of bank privatisations for the EU member countries (excluding Luxembourg), comparing them with the equivalent statistics for the OECD and non-OECD countries. We use the data provided by Boehmer, Nash and Metter (2004), which go only until 2000. This limit is acceptable with regard to the fact mentioned above that bank privatisation occurred mainly in the 1990s.

As we can see in Table 12.1, the EU countries were bank privatisation champions. Over the period 1982–2000, they undertook 71 per cent of the number of bank privatisation transactions carried out by the OECD countries

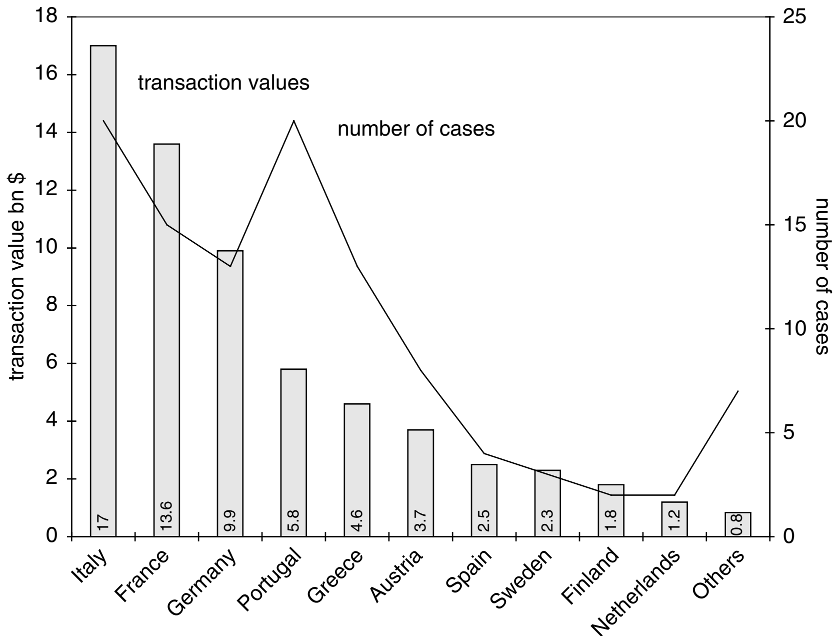


Figure 12.2 Bank privatisations in the EU15 countries, 1985–2007
Source: Privatization Barometer Database

and received 84 per cent of the total proceeds from such privatisations. This is not surprising because in the other large countries in the OECD, the USA and Japan, banks were generally private from the beginning, so that there was nothing to privatise.[5]

Furthermore, the average size of a bank privatisation in the EU countries was larger than the OECD average (118 per cent) and more than three times larger than that in the non-OECD countries (340 per cent). More specifically, the following features of bank privatisations across the three sets of countries can be noted.

- Share issue privatisations are more common in OECD countries than in non-OECD ones. This is even more so in the EU countries, thus indicating that the existence of a developed capital market is instrumental for the implementation of bank privatisation policies, especially where such privatisations are relatively large.
- The average share of bank privatisation transactions in the total number of and in the proceeds from such transactions irrespective of industry is lowest in the non-OECD countries, while it is relatively low in the EU countries by comparison to the OECD ones. This implies a relatively more

Table 12.1 Bank privatisations in non-OECD, OECD and EU countries 1982–2000

	Non-OECD countries	OECD countries	EU countries
1. Number of sample countries	33	18	14
2. Number of corresponding transactions	156	114	81
3. Average size of transactions (US $ million)	247	710	840
4. Total value of transactions (US $ million)	38,473	80,897	68,015
5. Percent of transactions through share offering %	43.6	49.6	*62.6
6. Average percentage share of bank privatisations in total privatisations of sample (number of deals) %	9.0	19.0	13.5
7. Average percentage share of bank privatisations in total privatisations of sample (proceeds) %	11.0	18.0	15.1

*Estimated from the Privatization Barometer Dataset for the period 1985–2002
Source: Boehmer, Nash and Metter (2004); adjusted for the EU countries

limited relief of bank privatisations for the fiscal pressures in the EU, as well as a comparatively limited impact on equity ownership, although the prevalence of share offerings as a means of EU bank privatisation works in the opposite direction.

Comparisons across EU countries The number and size of bank privatisation transactions in the EU countries over the period 1982–2000 are shown in Table 12.2.

As we can see, Italy and France head the list, having carried out a large number of bank privatisation transactions and having derived relatively large amounts of proceeds from them. They are followed, albeit at some distance, by Germany, Spain, Sweden and Belgium, in terms of privatisation proceeds, and Greece and Portugal, in terms of number of transactions. In fact, these eight countries were the main EU privatisers in the period under discussion, accounting for 86 per cent of all bank privatisation transactions and 93 per cent of the total value of such transactions.

The UK, on the other hand, stands out for its limited share in the EU bank privatisation activity over the period in question, while Ireland had none.

Table 12.2 Number and size of privatisation in the EU banking sector, 1982–2000

Country	Number of bank privn transns	Bank privn as % of total transns in each country	Value of bank privn transns US $ million	Bank privn as % of total value of privns in each country	% Distribution of privn transns across countries (in terms of number)	% Distribution of privn transns across countries (in terms of value)	Average size of bank privn transaction US $ mio	Ave size of bank privn transaction as % of EU Average
Austria	4	12	2,157	19	4.9	3.17	539	64.2
Belgium	7	50	3,726	45	8.6	5.48	532	63.4
Denmark	1	14	110	1	1.2	0.16	110	13.1
Finland	1	4	134	1	1.2	0.20	134	16.0
France	9	21	13,208	18	11.1	19.42	1,468	174.7
Germany	5	9	5,597	4	6.2	8.23	1,119	133.3
Greece	10	33	2,430	25	12.3	3.57	243	28.9
Ireland	0	0	0	0	0.0	0.00	0	0.0
Italy	19	25	25,593	22	23.5	37.63	1,347	160.4
Netherlands	2	8	1,322	7	2.5	1.94	661	78.7
Portugal	12	19	3,768	13	14.8	5.54	314	37.4
Spain	4	10	5,610	13	4.9	8.25	1,403	167.0
Sweden	4	25	3,405	16	4.9	5.01	851	101.3
UK	3	2	955	1	3.7	1.40	318	37.9
Total	81	–	68,015	–	100	100	840	–
Average	5.79	–	840	–	–	–	–	–

Source: Boehmer, Nash and Metter (2004), Table 3B, adjusted

This is not surprising in view of the prevalence of the private sector in banking in these countries. The Scandinavian countries also displayed low bank privatisation activity, with the exception of Sweden, which was in a middle position by comparison to the other EU countries.

The average size (in US $ million) of bank privatisation transactions varied considerably across the EU countries. This is partly related to the size of the banking sector. For example, Greece and Portugal pursued bank privatisations with particular vigour, as evidenced by the large number of transactions carried out in each country, 10 and 12 respectively, by comparison to 19 in top privatiser Italy and 9 in top privatiser France. However, because of the comparatively low total value of these transactions, their average value was relatively low in both Greece and Portugal. On the other hand, in the case of countries with a large banking sector, such as France, Germany, Spain and Italy, a high average size of bank privatisation indicates not only the size of the banking sector, but also the emphasis placed on privatisation policy by their respective governments.

Within each country, bank privatisations accounted for a varying share of total privatisations, ranging from 2 per cent in terms of number of deals and 1 per cent in terms of value in the UK – where private banks prevail anyway – to nearly 50 per cent in Belgium (see Figure 12.4). Belgium is however an exception, insofar as the corresponding figures in the other EU countries are considerably lower. For example, Greece, a heavy bank privatiser during the 1990s, recorded a 33 per cent share in relation to the total number of privatisation transactions and 25 per cent in relation to their value, followed by Italy, with a share of 25 per cent and 22 per cent respectively.

Result: the end of public commercial banks As a result of these privatisations the role and weight of the state in the banking sector in Europe has diminished dramatically in the past twenty years (see Figure 12.3). Still in the 1980s, state-owned commercial banks played a leading or significant role in most Western European countries (with the exception of the UK). Two decades later the vast majority of major commercial banks are traded on the stock market, in some cases with residual minority state-ownership. Commercial banks controlled by European governments are almost extinct – the notable exception being Germany, where regional governments' influence is still significant for the Landesbanken and the public – mostly municipality owned – savings banks hold a very strong market position in the retail sector.

As a further general result of the wave of bank privatisations the substantially diverse ownership structures of the banking sectors within the EU have become more uniform: In the four countries with a large or dominant position of state-owned banks in the first half of the 1980s – France, Italy, Belgium, Greece – privatisations have changed this structure towards a predominantly private one and thus made it more similar to the structures in the other countries.

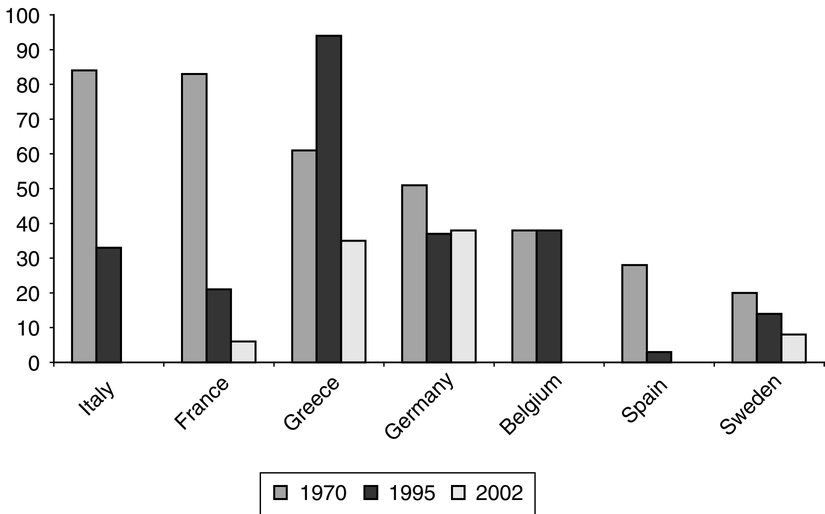


Figure 12.3 Share of public ownership in bank assets
Source: La Porta et al. (1995 abd 2002); Micro et al. (2007)

12.4 Financial restructuring and bank privatisation in the new CEE members of the EU

In the ten Central and Eastern European countries which entered EU in 2004 and 2007 the reform of the financial system began later than in the EU15 and took place under completely different conditions. It was embedded in the transformation of the political and economic systems from state socialism to capitalism. Liberalisation, deregulation and privatisation were essential cornerstones of this transition.

For the financial systems, transition was particularly complicated. Their completely centralised banking structure had to be broken up and capital markets had to be created from zero. The first measure, in several countries already taken at the end of the 1980s, that is, before the collapse of the old system, was the separation between the central bank and commercial banks and the (re-)introduction of a two-tier banking system. Former branches of the central bank became independent commercial banks, although they remained in the first phase in public ownership. This meant that they had to actively compete amongst each other and with numerous newly created banks for resources and customers.

According to Barisitz, bank reform in the new CEE members evolved in two systematic phases with different duration and time patterns (Barisitz, 2008, table 5.30). The *first phase* started with the break-up of the old system and the emergence of independent commercial banks at the end of the 1980s. It was characterised by three problems: First, there was a widespread

lack of knowledge about the management and control of a decentralised banking system. Second, the newly independent commercial banks suffered from a heavy burden of bad loans and had to be recapitalised by the state in order to be viable. Third, the development of these banks was particularly affected by a sharp transformation crisis in the non-financial sector during the first years of the 1990s.

The new financial systems in almost all transition countries suffered mostly from inadequacy of the normative framework which was too liberal. Indeed, the fast and supposedly efficient creation of a private financial sector was given priority over transparent gradualism. Financial supervisors were not given enough authority for control or/and there was not enough knowledge of finance. As a result, the number of financial institutions increased too fast and their troubles expanded quickly.[6] Non-performing loans began to rise which led quickly to huge losses and crises of financial institutions in most countries. Under these conditions privatisation of larger state-owned banks was not attractive for strategic investors, and where privatisation took place it was in the form of 'surface privatisation' (Barisitz, 2008), that is, voucher privatisation or management-employee buy-outs (MEBOs). These were not accompanied by strategic reorientation with a long-term time horizon. Vouchers were usually quickly sold to investment funds, and MEBOs were often followed by cash-stripping or speculative operations to boost prices and transform the assets of the corporations into individual wealth of their owners.

The *second phase* started with the tightening of bank regulation/supervision, and the establishment of hard budget constraints. In some countries (like Hungary) this was the case already in the early 1990s, in others it began much later. Together with stricter bank regulation the legal environment (rule of law) had stabilised and property and creditor rights were strengthened. As a consequence banks ended their lenient lending behaviour and became more cautious. It was not before the beginning of this phase that large state-owned commercial banks became attractive targets for private investors, and the phase of 'in-depth privatisation', that is privatisation with a long-term strategic perspective on the side of the buyer began. Once started, the process accelerated enormously, and within few years most large banks were privatised. According to the empirical data collected by Andrews (2005, pp. 30–39) out of 41 bank privatisations in 9 new CEE members (except Slovenia) only 11 occurred until 1996, while in the next five years 26 banks (9 in Poland, and 7 in and Hungary) were privatised, eight in the year 2000 (see Figure 12.4).

What distinguishes strategic bank privatisation in the CEEC from the same process in the EU15 is a high number of sales to foreign institutions. The reason for this was on the one hand, the lack of sufficient domestic capital, and, on the other hand, the perspective to benefit from advanced technology and experience which was accompanying foreign investment

Figure 12.4 Bank privatisations in the CEE members of the EU, 1992–2004
Source: Privatization Barometer Database; author's calculations

in banking. On the side of the investors the underdeveloped financial markets became a very attractive field of investment once political stability and strong bank regulation were in place and major debts removed from the balance sheets. Through acquisitions foreign banks became major owners of the main financial institutions in almost all transition countries. This process of foreign acquisitions was re-enforced in the first years of the current decade. In the end, amongst the larger banks in transition countries only OTC in Hungary, PKO BP in Poland, and the key Slovenian banks have remained in domestic hands.

In 2006, the (unweighted) average of foreign ownership in 10 CEE countries amounted to 81 per cent of assets and to 95 per cent and more in Estonia, Slovakia, Hungary, and Czech Republic (see Table 12.3). A few international banking groups from EU15 play a leading role in the CEE banking system; Scandinavian banks in three Baltic countries, Austrian, German, Italian and French in other countries (see Table 12.4).

Underdeveloped banking (indicated by shares of assets, gross loans and deposits in GDP), low banking penetration ratios and good macroeconomic performances have assured high profits and offered ample opportunities for expansion. Moderate risk due to relatively modest shares of banking groups' assets (see last column in Table 12.4) in their CEE business allowed a 'limitless' credit supply for 'negligible size market', that is borrowing at home and lending in a host country. Retail banking has remained the most dynamic part due to households' desire to converge to EU living standards. The most active foreign banking group, UniCredit, which operates in all ten

Table 12.3 Characteristics of the CEE banking systems in 2006

Country	Number of banks	Shares: of foreign banks		Shares: of 5 top banks	% GDP: assets	% GDP: gross loans	% GDP: deposits	Banking penetration[a]
	2006	1995	2006	2006	2006	2006	2006	2006
Poland	645	19	70	46	68.6	34.3	41.1	62
Hungary	38	36	95	54	100.1	58.0	45.6	69
Czech R.	37	23	96	63	97.3	42.0	63.9	81
Slovakia	24	23	98	67	87.6	40.8	56.8	81
Slovenia	27	10	35	62	113.5	64.5	57.7	99
Estonia	14	29	99	98	117.1	84.5	50.6	n/a
Latvia	25	28	57	69	140.9	87.0	41.7	n/a
Lithuania	77	16	90	82	74.1	51.0	36.4	n/a
Bulgaria	29	–	81	50	86.0	46.2	55.5	39
Romania	41	–	89	62	51.2	28.0	29.7	48

[a] population aged 15+ having a banking relationship with a bank.
Source: UniCredit Group (2007)

Table 12.4 Major foreign banks in the CEE banking sector

Country bank	Share of assets in banking sector of a CEE country: BG	CZ	EE	HU	LT	LV	PL	RO	SK	SI	Share of assets/ profits in the CEECs
UniCredit	15.3	7.2	0.8	6.3	3.4	1.7	15.4	5.1	8.2	5.0	11/25
Société Générale	3.0	15.7	–	–	–	–	–	16.0	–	5.4	4/71
Intesa Sao Paolo	–	–	–	8.7	–	–	–	–	16.6	5.3	5/6
KBC	3.4	21.2	–	9.1	–	–	3.1	–	12.8	10.0	15/21
Erste	–	17.7	–	7.7	–	–	–	25.3	17.9	–	34/75
Raiffeisen Int.	10.1	3.1	–	8.0	–	–	2.8	8.0	15.2	2.8	48/n/a
OTP	13.3	–	–	20.4	–	–	–	–	–	–	–
Swedbank	–	–	53.2	–	24.0	23.5	–	–	–	–	–

Figures refer to 2006 or 2007
Source: UniCredit Group (2008)

CEE countries predicts growth of 23 per cent yearly on the deposit side and 29 per cent on the lending side in the period 2006–2010 and a strong bank profitability of 15 per cent.

As a result, the ownership structure of financial sector in CEE countries differs considerably from the ownership structure in EU15. While in the latter the share of big financial corporations in domestic hands exceeds the corresponding share of big non-financial corporations in domestic hands, the opposite is true in CEE countries; while domestic ownership is also dominant in the non-financial sector, in finance all or most large banks and a substantial part of insurance corporations are foreign owned – with the exception of Slovenia.

It is remarkable that this difference exists also for those countries of the EU15 in which the largest and most important parts of the financial sector were formerly state owned and were privatised during the 1990s. Privatisation in Italy, for instance, resulted in the emergence of a group of large domestically owned private banks and subsequently led to a wave of further domestic mergers between them. The same is true for formerly state-owned banks in France, for which domestic 'noyaux durs' were formed during the privatisation process. Only very recently bank mergers and takeovers across EU15 countries have taken place (Santander-Abbey National, Unicredito-HVB, ABN Amro – Banca Antoveneta, Credit Agricole – Emporiki, BNP Paribas – Banca Nazionale del Lavoro, Fortis/RBS/Santander – ABN Amro).

What are the benefits and what are the costs of this uniquely strong presence of big Western (mostly European) banking groups in the CEE members of the EU? On the one hand, foreign investment has undoubtedly brought a transfer of technology and proficiency in bank management and therefore considerably supported and accelerated the restructuring and modernisation of commercial banking, which otherwise would have required much more time and domestic resources. Insofar Foreign Direct Investment (FDI) in banking has contributed to the increasing shares of the financial sector in the CEE countries, to the stabilization of the banking systems, and to the integration of European financial markets. Whether FDI in finances contributed to a long-run growth of Gross Domestic Product (GDP) is less clear (see Mencinger, 2003).

However, there are also considerable problems inherent in privatisation through foreign acquisitions:

First, the privatisation brought additional economic power to big banks in the EU and therefore strengthened the line of deregulatory policies which these banks favour. The almost complete take-over of national commercial banking generates dangerous asymmetries which make the CEE countries more dependent and vulnerable. For large Western banking groups like UniCredit, KBC, or Citigroup business in the CEE countries, particularly in small countries, is very attractive because of high profit rates and only a

small and non-vital proportion of their activities. Decisions of withdrawal or restructuring in the interest of the bank group – which may be reasonable and rational from the perspective of the firm – can become of vital – or deadly – importance for the countries affected. Such dependence of a whole sector – and the whole economy – on the decisions of one or few private banking groups is certainly not conducive for financial and economic stability, and it weakens political sovereignty and democracy.

Second, high profit rates in CEE banking imply large outflows of capital which are more and more shaping current account balances of CEE countries; the income account deficits of CEE countries as a group began to grow dramatically after 1999; in 2005, they surpassed the entire current account deficit. The privatisation of the financial sector which was the major target of FDI in CEE countries might therefore turn to a major obstacle to growth and a threat to economic stability of CEE countries when outflows of profits become larger than sales of the remnants of domestically owned productive assets.

Finally, privatisation of the financial sector in CEE countries speeded up the creation of cross-border banking groups and exposures within the EU banking system. Potential financial crises would therefore have significant cross-border implications and the existent EU arrangements for financial stability which had been set-up when banks were active predominantly within national borders, may not ensure timely, efficient and least-cost solutions in a cross-border context.

12.5 Conclusion: Convergence and asymmetries

In the mid-1980s, one could distinguish three groups amongst the current 27 member countries with regard to the ownership structure of their banking sector:

- In a minority of countries in the old EU – mainly the UK, Ireland, and Spain – banks were almost completely in private ownership.
- In the majority of the old EU countries there existed private banks along with strong state-owned institutions at the federal, the regional and the community level.
- In all ten transition countries the financial structures were (almost) completely shaped by a monolithic system of state-owned banks.

In the two decades since then three developments have changes the situation:

The first is a ***strong convergence towards the patterns of private ownership structures.*** This required no changes in the first country group. In the second group it was embedded in the more comprehensive process of market

opening, liberalisation and deregulation of the European Single Market. In the third group the establishment of private ownership structures in finance went along with the overall transformation from a state-socialist to a capitalist economy. This process of convergence has been nearly completed. The formerly very diversified ownership structures have been replaced by a uniform dominance of private ownership.

The second development is a strong process of ***consolidation and concentration*** through bank mergers and acquisitions. In all EU countries the number of banks is currently much lower than it was 15 years ago, and in most countries the market shares of the largest banks have considerably increased (see European Central Bank, 2006, chapter 4.1).

The third development is the emergence of a ***distinct difference in the relationship between domestic and foreign ownership in the EU***. Whereas in the EU15 financial institutions are still in their majority domestically owned, in the transition countries they are overwhelmingly foreign owned. The former is the result of a wave of national consolidation through mergers and acquisitions to form national bank champions. The latter is the result of Western acquisitions in the CEEC during the second phase of restructuring of the bank system.

During the last quarter of the century financial integration in Europe has made big advances. At the same time, the form of this integration has generated serious problems for the stability and cohesion of the European economy as a whole. First, the virtual disappearance of state-owned banks in most countries has deprived governments of important instruments for democratic control and influence over economic development. Second, deregulation and privatisation have led to new power positions of private banks and financial conglomerates as national champions in the Western European countries and to a very problematic dependence of the banking systems in the new member countries of Central and Eastern Europe on the strategies of Western bank corporations who own most of the Eastern banks. Third, the absence of an effective European bank and financial market supervision – and the powerlessness of national supervisory structures in the face of financial cross-border integration – have made the European financial systems and the European economy and societies as a whole very vulnerable – as the recent banking and financial crisis demonstrates with alarming clarity. To change this situation two remedies are necessary: First, the set-up of new common rules for banks and other financial institutions must be developed and implemented, on the global or at least on the European level. Second, the narrow and counterproductive straitjacket for macroeconomic policy must be abandoned and replaced by a macroeconomic framework in which is room for sustainable growth, full employment, social cohesion and financial stability.

Notes

1. "Spain experienced the swiftest deregulatory process, principally in the late 1980s. It demolished most conduct rules, for example, rate regulations and credit quotas, and market entry as well as the introduction of new banking products were rapidly eased" (Vesala, 1995, p. 108).
2. For example, Megginson's recommendation to policy-makers is set in unambiguous terms: "If the objective of a country is to establish a more efficient and market-oriented economy, reducing the influence of the state on credit allocation decisions is critically important" (Megginson, 2005, p. 1961).
3. In this respect, the role of the international financial institutions in promoting privatisations should not be underestimated. Viz., the IMF conditionality principle for funds extended to countries in need, as well as the practice of the World Bank to attach privatisations to aid disbursements in low-income countries. See Bayliss (2000) for an excellent critique of the privatisation policy of the World Bank.
4. This is a point raised by Stiglitz (1999).
5. The picture would not change dramatically, if Mexico with 20 bank privatisations which joined the OECD in 1994 were included in the OECD figure.
6. Slovenia was an exception to that. It established a strong independent central bank and insurance supervisory authority at the independence in 1991. Most banks were privatized indirectly through the privatisation of their 'shareholders' which were socially owned companies; their privatisation therefore implied privatisation of the banks. The licensing process for banks and insurance companies was thorough so that Slovenia, as the only transition country, did not experience a banking crisis in 1990s. With minimal founding capital requirements three times higher than in EU15, expansion of banking sector with new banks was limited. Their number nevertheless doubled from starting 16 banks at the time of independence. As large state-owned banks were burdened with un-repaid debts from depressive enterprise sector, Slovenia was rich enough to use the state budget for their rehabilitation. Indeed, two largest banks, LB and KBM in which losses exceeded their capital were therefore actually nationalized. Gradualism helped by waiting with privatisation until enough domestic capital was created to be able to participate as competitor to foreigners in privatisation of these banks. As a result, the majority of financial institutions have remained in majority domestic (residential) ownership, which is considered important for country's economic development and preservation of its sovereignty and identity.

References

Andrews, A. M. (2005) State-Owned Banks, Stability, Privatisation and Growth: Practical Policy Decisions in a World Without Empirical Proof (IMF Working Paper WP/05/10, January).

Barisitz, S. (2008) *Banking in Central and Eastern Europe 1980–2006* (Milton Park and New York: Routledge).

Bayliss, K. (2000) *The World Bank and Privatisation: A Flawed Development Tool* (London: PSIRU, University of Greenwich, November).

Boehmer, E., Nash, R. C. and Netter, J. M. (2004) "Bank Privatisation in Developing and Developed Countries: Cross-Sectional Evidence on the Impact of Economic and

Political Factors", *Journal of Banking & Finance*, Vol. 29, Nos 8–9, August–September 2005, pp. 1981–2013.
Clarke, G. R. G., Cull, R. and Shirley, M. (2005) "Bank Privatization in Developing Countries: A Summary of Lessons and Findings", *Journal of Banking & Finan*ce, Vol. 29, Nos 8–9, August–September, pp. 1905–1930.
De la Motte, R. (2007) Database on Public Banks in Europe (Manuscript for PRESOM).
European Central Bank (2006) Report on EU Banking Structure (Frankfurt: ECB).
Frangakis, M. (2007) Privatisation in the EU – An Overview (Paper Presented for PRESOM, January).
Grahl, J. (1997) *After Maastricht – A Guide to European Monetary Union* (London: Lawrence & Wishart).
James, H. (1993) "General Trends: A Search for Stability in Uncertain Conditions", in Pohl, H., 1993, pp. 354–356.
Kindleberger, Ch. P. (1984) *A Financial History of Western Europe* (London/Sydney/Boston: George Allen & Unwin).
La Porta, R., Lopez-de-Silanes, F. and Shleifer, A. (2002) "Government Ownership Ownership of Banks", *The Journal of Finance*, Vol. 57, No. 1, pp. 265–301.
Levine, R. (2003) The Corporate Governance of Banks (Global Corporate Governance Forum, Discussion Paper No. 3, July).
Megginson, W. L. (2005) "The Economics of Bank Privatisation", *Journal of Banking & Finance*, Vol. 29, Nos 8–9, August–September 2005, pp. 1931–1980.
Mencinger, J. (2003) "Does FDI Always Enhance Economic Growth?" *Kyklos*, Vol. 56, pp. 491–508.
Micco, A., Panizza, U. and Yanez, M. (2007) "Bank Ownership and Performance. Does Politics Matter?", *Journal of Banking and Finance*, Vol. 31, No. 1, January, pp. 219–241.
Pohl, H. (ed.) (1993) *Europäische Bankgeschichte* (Frankfurt: Fritz Knapp Verlag).
Privatization Barometer Database, www.privatizationbarometer.net/database.php (accessed 15 December 2008)
Russell, E. (2008) *New Deal Banking Reforms and Keynesian Welfare State Capitalism* (New York/London: Routledge).
Stiglitz, J. E. (1999) Whither Reform? (Keynote Address, Annual World Bank Conference on Development Economics, Washington DC: World Bank).
UniCredit Group (2007) Banking in CEE and the Role of International Players (UniCredit Group, New Europe Research Network, July).
UniCredit Group (2008) CEE – Still the Right Bet (UniCredit Group, New Europe Research Network, July).
Vesala, J. (1995) "Banking Industry Performance in Europe: Trends and Issues" in OECD (ed.), *The New Financial Landscape: Forces Shaping the Revolution in Banking, Risk Management and Capital Markets* (Paris: OECD Documents), pp. 97–165.

13
Privatisation Trajectories in Europe: A Cross-Sector View

Marica Frangakis

13.1 Introduction

The previous chapters of Part II examined in detail the way liberalisation and privatisation were introduced in a number of sectors across Europe. The sectors reviewed include: (1) industry in general and the network industries, in particular; (2) two major public services sectors, health care and education, with special emphasis on tertiary education; (3) pensions, as part of the social security sector; (4) and the banking sector. Although the approach is not uniform across the various chapters, the aim of these reviews is to highlight the main processes via which liberalisation and privatisation changed the post-World War II paradigm, from one of strong state presence and intervention to one of steadily increasing dominance by the private sector. Indeed, it may be argued that the past thirty years, over which this transformation occurred, constitute a 'transformative period', that is, one during which a shift in the prevalent paradigm took place.

The aim of this chapter is to bring together the main lines of argument put forward by the cross-sector reviews, and to outline the broader picture that emerges from them. Accordingly, we shall look into the following aspects of the privatisation process in Europe: (1) rationale and drivers; (2) process and types; (3) impact, economic, social and political, where 'privatisation' encompasses the accompanying 'liberalisation' process and 'Europe' refers to both Western and Eastern Europe, while special attention is paid to the role of the ever-expanding European Union.

13.2 Rationale for and drivers of privatisation

The rationale for privatisation, famously put forward by the first Thatcher government in the late 1970s and early 1980s in the UK, included a multiplicity of objectives, spanning the economic, social and political agenda, with strong ideological undertones. Arguments in favour of the private sector included its superiority in terms of efficiency and growth, as well as

stressing the role of the individual and of individual choice in society. Neo-liberalism had arrived.

While neo-liberalism became a hegemonic doctrine over the decades that followed, the actual drivers of privatisation varied across sectors. Furthermore, the buoyancy of the early Thatcher years was toned down, as privatisation policy largely failed to deliver the promised outcome. The following drivers of privatisation, also employed as arguments in favour of reducing state presence, emerge from our cross-sector review:

- Increasing efficiency,
- Reducing public expenditure,
- Developing/supporting the capital markets,
- Promoting a shareholder society,
- Strengthening individual choice,
- Reducing the political influence of the trades unions.

The *efficiency argument* was most heavily employed in the 1980s in relation to the industrial sector and to the network industries. In the aftermath of the repeated oil crises of the 1970s and of the effective collapse of the Bretton Woods agreement and of the system of fixed exchange rates, state-owned enterprises appeared as laggards. This was even more so in the network industries, which were by definition natural monopolies. Privatisation and the accompanying market liberalisation processes were thus put forward as the remedy to the ills of the public sector.

As pointed out in Chapter 7, skepticism about the efficacy of the public sector, on the one hand, and the growing pressures of internationalisation, on the other, paved the way for the dismantling of state ownership in industry in the 1980s and 1990s. In the case of the network industries, the efficiency argument was theoretically wrong, as it assumed that privatisation brought with it a 'first best' solution, when in fact this was far from being the case.

In the case of the Central and Eastern economies (CEEs), privatisation and liberalisation were at the epicenter of an all-embracing transformation from a Soviet-style economy to a capitalist, market-based one. Understandably, the efficiency argument carried great importance, even though it was hardly adequate to describe the transformation process actually taking place.

The efficiency argument came up in other areas, too, such as the public services, although it was not a primary consideration, as compared with other drivers and especially the *budgetary constraint argument*. More specifically, although the revenue from privatisation acted as a short-term incentive for governments to adopt such policies, it was the saving of public expenditure that was a major privatisation drive in the case of the public services.

Chapters 9 and 10 review the privatisation experience of health care and education, with special emphasis on tertiary education. In both instances,

the growing needs of the European population have led to an increased demand for the services of these sectors and thus to increased public expenditure. In the 1990s, such expenditure could not be easily accommodated within the public budget, due to the twin pressures to reduce the public deficit and debt, deriving from the international context of floating exchange rates and the need to prepare for the introduction of the single currency in the EU.

Similar budgetary considerations were especially forceful in the case of pension reform, whereby pressure was applied to transform the defined-benefits system into a defined-contributions one. In particular, it was held that such a reform would secure the long-run sustainability of the public budget. As argued in the Chapter 10, this approach is fallacious to the extent that it focuses on demographic trends, while it ignores the implications of growth, income inequality and the labour-market conditions for the sustainability of the state-funded pension system.

In the case of pension reform, however, another driver further emerged as a major argument in favour of privatisation, that of *capital market integration*. Indeed, the release of huge amounts of funds that were directed to the European capital markets in the late 1990s and in the 2000s by the pension funds boosted their further deepening and thus integration. However, this trend encouraged increasing risk-taking behaviour on the part of pension funds, especially the private ones. The financial crisis that began in 2007 appears to have brought this tendency to an abrupt end, although its long-term implications are still to be seen.

The financial sector further gained from the privatisation of European banks, which occurred on a large scale in the 1990s. In this case, the main argument put forward was the need to separate government influence from the resource allocative role of banks and the assumption that privately run banks are by definition more efficient in the allocation of credit. In the course of approximately ten years, the presence of the state in the banking sector was reduced to a minimal level, as shown in Chapter 12. However, the debacle accompanying the financial crisis has discredited the '*superiority of the private sector*' *argument*.

In the case of the CEEs, bank privatisation must be viewed against the monobank system, which was thoroughly transformed in the 1990s, resulting in a two-tier system, including a central bank and a number of commercial banks. In this instance, privatisation actually meant the establishment of many Western European bank subsidiaries in the CEEs, which ended up with an extensively foreign-owned banking sector.

Concomitant to the capital market argument was the claim that privatisation encouraged the *expansion of a shareholder society*, whereby individuals were given the opportunity to share in the wealth created by the privatized enterprises. This was an ideological, as much as a political, argument for privatisation, widely employed in the early years, as an increasing number of

state-owned enterprises were transferred to the private sector. As it became evident that individual shareholders were more interested in the short-term gains made from selling their shares at a high price than holding on to them for any length of time, this argument lost much of its force.

Yet another argument that acted as a driver of privatisation on the ideological/political level, was that of *promoting individual choice*. This was central in the reform of the educational system (parent/student choice), as well as of the health care system (patient choice). That is, by introducing market elements in the state-run system of public services, individuals have a wider choice. While this is indeed a tautology, what is not made explicit is that for the same reason, the poorer sections of the population are faced with shrinking choices, as the role of the state in the provision of many of these services recedes.

Overall, within the broad framework provided by the rationale for privatisation, different arguments were applied with varying force across the various sectors of the European economies, depending on the particular circumstances pertaining in each case. Although the institutions and political traditions of different countries influenced the interaction between social, economic and political factors, a process of convergence is observed. This is partly true even of the Western and Eastern European experience, in spite of their dramatically different starting points.

13.3 Process and types of privatisation

The process of privatisation across sectors and regions presents a number of common features, pertaining to its starting point and its evolution. The post-World War II period is known as the 'golden era', for its high growth rates and social welfare services provided to the citizens of most European countries. The presence of the state in the economy was pervasive, while full employment featured as one of the main government policy objectives. The challenge of the role of the state as guarantor of social welfare may be said to be the starting point of the privatisation and liberalisation process. It is an ideological and political challenge, which signified the ensuing shift in paradigm, as neo-liberalism replaced Keynesianism as the new hegemonic doctrine of economic policy.

This starting point is shared by the CEEs, in spite of their different historical background. In fact, as the almost totally state-controlled economies of these countries collapsed, the withdrawal of the state was even more severe than in the rest of Europe.

While the starting point of privatisation may be viewed in largely ideological and political terms, its evolution reflects the weakening of industrial capital and the increasing weight of financial capital and interests both in Europe and globally, following the dismantling of controls of the financial markets. The role of finance as a driver of privatisation is discussed in

Chapter 5. Suffice it to say here that our cross-sector review confirms this observation, not only in the obvious cases of pension reform and bank privatisation, but also in the cases of health care and tertiary education.

On the other hand, our cross-sector review reveals a number of different types of privatisation, which however tend to converge across regions within any particular sector. This is partly true of the CEEs also, although their different starting point needs to be borne in mind. Such types include: (1) the transfer of ownership, met especially in the industrial sector and in the banking sector; (2) the progressive market opening and network unbundling, observed in the network industries; (3) the introduction of quasi-market principles and administrative methods in the public services, as shown by our review of the healthcare and education case studies; (4) the reformulation of the framework rules, as is the case of pensions.

The *transfer of ownership from the state to the private sector* was the most common type of privatisation, observed especially in the industrial sector (excluding the network industries), in the early years and in the banking sector, at a later stage. This transfer took a variety of forms, ranging from the direct sale to a strategic investor to the sale of share capital through the stock exchange. For obvious reasons, where the capital market was not developed, direct sales were preferred. Furthermore, in the case of the CEEs, in view of the lack of domestic capital resources, the transfer of ownership assumed many forms, such as voucher privatisation, management and/or employee buy-outs, as well as foreign direct investment, especially since the mid-1990s.

In the case of the network industries, privatisation was preceded by the *separation of different functions, thus facilitating the transfer of ownership*. In particular, unbundling split up various vertically integrated undertakings into separate units, while marketisation introduced commercial or market-based principles into the management of public enterprises. At the same time, the relevant market was liberalized, in order to allow for competition in the supply of goods and services. In addition, independent national regulatory authorities were established, alongside corresponding EU ones, for the purpose of overseeing and coordinating the liberalisation process. However, as pointed out in Chapter 8, such regulatory authorities were exposed to the risk of regulatory capture due to their limited resources and status. Thus the splintering of the transaction chain – whereby infrastructures are separated from services, regulation from implementation and short-term transactions from long-term ones – led to a fragmentation of policy and of decision making, with negative implications for the sector.

Marketisation is the main means of allowing business interests to enter the public services. In particular, the notion of the market has been introduced in a variety of ways under the general label of 'reforms', promoted by the so-called New Public Management (NPM) of public services. Such reforms include private–public partnerships, contracting out and various forms of increased local autonomy, competition, user choice and the introduction of internal or 'quasi-markets'. The introduction of such techniques

is most evident in health care, although the concept of the NPM is also making inroads in tertiary education, where it is aided by the EU's Bologna Process, promoting the harmonisation of degree structures and organisational reforms aiming at curtailing the role of government.

It is worth pointing out that both the health care system and the educational one are socially and politically complex structures, varying a great deal across countries. Their main, unifying feature is the central role played by the state as the provider and/or guarantor of social welfare. While this feature is gradually receding, the introduction of the various means of marketisation is leading to a convergence of such systems.

Marketisation is also the main means of pension reform. In particular, as pointed out in Chapter 11, "the overall purpose of pension reform is to substitute partly or totally the pay-as-you-go (PAYG) system by a private insurance system run on capitalization of individual savings on an actuarial basis" (p. 2). In addition, the *overall framework of pension provision is being revised,* thus reducing the traditionally central role of the state, while augmenting that of individual responsibility. The role of the EU is instrumental in this respect. For example, funded schemes are encouraged, incentives are given for people to retire at a later age, the portability of pensions is made easier, the benefits provided by public pensions are reduced, and so on. In this instance, too, a process of convergence is observed across the European countries.

Overall, the process of privatisation and liberalisation and the forms these assumed across sectors and regions was subject to the particular conditions pertaining in each case. Over time, however, it may be argued that converging influences prevailed, leading to relatively similar patterns of marketisation and commodification across different sectors. This is mainly due to the influence of global capital and the increasing significance of financial interests within it.

13.4 Impact

In spite of its fast spreading across the world and its acquiring a hegemonic position quickly, privatisation did not deliver the promised economic outcome in terms of higher productivity and lower prices, with few exceptions. However, its negative social implications were comparatively clearer. Similarly, the strengthening of private business interests vis-à-vis the state and society, impacting on social solidarity and the public interest, is largely undisputed. In this section, we shall look into the economic, social and political impact of privatisation and liberalisation across the various sectors reviewed in Part II.

Economic impact Privatisation and liberalisation were sold on the ticket of efficiency; a blanket term, used to denote the superiority of market principles and of profit-seeking behaviour over those of social solidarity and of the welfare state. However, the evidence accruing over a long period across

the various sectors and regions does not corroborate this argument, which remains at best inconclusive.

For example, the evidence with regard to changes in the price level in the network industries is unclear, given that market liberalisation, combined with significant market power and a low elasticity of demand, tends to limit the fall in prices and to result in price volatility. In fact, there are examples of price manipulation strategies by large private suppliers, such as Enron in the United States, which artificially created the impression that power lines were congested, by overstating the power it was planning to deliver over them and being paid in order to relieve congestion!

Furthermore, the evidence on price convergence across countries in the network industries is not clear, neither is that on productivity gains, which may be due to technological change, rather than to the rationalisation of production. On the other hand, the link between competition and the quality of services in the sectors appears to be negative, when studied in detail. This is because the incentive to innovate and to invest in infrastructures is reduced for private providers, who are more interested in short-term, applied projects, than in long-term, fundamental research.

Lastly, in view of the 'natural monopoly' characteristics of the network industries, privatisation has led to an increasing concentration of the sector. Thus, seven electricity transnational corporations dominate in Europe today. Three of these – Électricité de France (EdF), E.oN and RWE (both based in Germany) – control a majority share of generating capacity and retail sales in most European nations, while their share is growing (Hall, 2005).

In the case of the CEEs, the privatisation of industry helped them get restarted after the collapse of their economic and political system, as argued in Chapter 7 above. Even in this case, however, the efficiency gains were not uncontested.

In the case of health care and education, privatisation served the purpose of reducing public expenditure. Where this was achieved, it was mostly at the expense of the quality of services and of reduced accessibility for the poorer sections of the population.

Furthermore, it has been shown that introducing market-style competition into the public services, whereby a system of contracts replaces the centralised provision of goods and services, results in increased transaction costs – mainly administrative and advertising – offsetting any efficiency gains that may have been generated in the process. This is the case of the private insurance companies both in health care and in the pensions sector. In addition, the increasing consolidation of the private service providers reduces any gains to the consumer, while increasing private profit.

In the case of the educational system, there is no evidence that increases in private funding and in the involvement of private business has resulted in increases in the quality and efficiency of educational services. On the contrary, it is thought that a reorganisation of the school system towards

'autonomy' and competition tends to enforce a polarisation trend between 'good' and 'bad schools'. This is due to the cherry-picking of students by private schools, which results in public schools being seen as 'schools of last resort'.

In the case of universities, such a polarisation leads to an international university hierarchy, whereby certain countries specialise in producing knowledge by strengthening their university education and R&D systems, while others end up concentrating on basic education programmes. Thus, the knowledge-producing countries export, or sell, their educational services to the knowledge-consuming ones.

The economic impact of bank privatisation has largely fuelled a risk-taking behaviour not only by the banks, but also by the financial system as a whole, within which banks still play a significant role in Europe. The fact that this was actively encouraged by the EU, which completely overlooked the implications of greater financial integration for the stability of the system as a whole and for consumer protection, exacerbated the tendencies generated by the liberalisation and privatisation process. The financial crisis that erupted in 2007 disclosed in a dramatic way the shortcomings of the policy implemented in the financial services sector since the 1990s.

The financial crisis of 2007/2008 also had a detrimental effect on the reformed pensions systems, which became exposed to the vagaries of the stock market. As the price of financial assets dropped to unprecedented levels, many private pension funds found themselves in a very difficult position.

Overall, the economic impact of privatisation, as displayed by the cross-sector evidence reviewed in Part II, has been to raise uncertainty through an increase in the risk level private entities are prepared to undertake in the pursuit of short-term profit. Furthermore, such risk and costs thereof are passed on to society at large, in case of a system failure. The claim that privatised concerns operate more efficiently is not borne out by the evidence, while any such gains tend to be channelled mainly towards higher company gains, rather than to lower consumer prices.

Social impact This has been mostly negative, as demonstrated by the cross-sector reviews of Part II. In particular, privatisation and liberalisation have tended to reduce employment, to worsen labour conditions, through the expansion of flexible types of employment, to apply downward pressure on wages, to foster income inequality and to polarise society by providing greater choice to those who can afford it and less to those who cannot.

For example, the marketisation of health care provision affects negatively the employment conditions in the sector. In particular, employment becomes more precarious as a result of the expansion of flexible, part-time and temporary types of work, especially amongst nurses and auxiliary personnel. Furthermore, differences in pay across the private and the public

segments of the sector widen, with those working in the private part typically receiving lower wages, although specialist doctors' pay may be higher. To the extent that most nurses and much of the auxiliary personnel are women, the negative impact of marketisation is gender specific.

In addition, the rhetoric of 'patient choice' between providers, including private ones, in effect undermines the public sector, to the extent that public health care providers tend to receive revenue funding largely based on the workload they treat. Patients who opt for the private sector take with them the funding that corresponds to their treatment. Thus, 'patient choice' counterposes the choices of individuals to the stability of a system caring for the population at large. Further, since 'patient choice' can be exercised by those who can afford it, a two-tier health care system is established, undermining the notion of social solidarity that underpins public services.

Similarly, the implications of liberalisation and privatisation in education, and especially at the university level, for social cohesion are negative. The notion of equality of opportunity is severely damaged, while students' prospects tend to be largely determined by their family background. Thus, liberalisation and privatisation in the educational services sector has led to a shift from a modern, universalistic, integrating model aimed at educating citizens, focusing on the role of the state as guarantor of educational opportunities, to a more individualistic and differentiating model aimed at educating citizen-workers and focusing on the role of the market in guaranteeing that some consumers can freely choose educational services from a differentiated supply (Marrero and Hernandez, 2005). Also as the UK experience has shown, "the lesson of school choice over the last 15 years is that limited capacity leads to successful schools choosing pupils, rather than pupils choosing schools" (Needham, 2005, p. 153).

The reform of the pensions system towards an individualistic, rather than a solidaristic model, further impacts social cohesion in a negative way, to the extent that it accentuates pensioner poverty and income inequality. In this respect, women pensioners tend to suffer more given that their employment pattern is characterised by periods of unemployment, flexible and precarious employment.

Political impact Privatisation raises the issue of democratic accountability. Where the state is the provider of utility services and of public services, it is accountable to society through the democratic process, mainly through elections on the national and/or regional level, where the deeds of any party in government are put to the popular vote. Although the system of representative democracy may not be perfect, it serves the basic objective of democratic control. Where whole areas of government responsibility are transferred to the private sector, the principle of accountability is either weakened or altogether eliminated. This is a major flaw of the process of privatisation and liberalisation, about which there is surprisingly little

discussion. Although attempts have been made by governments to regulate the privatised sectors, these have not been particularly successful. In fact, as argued in Chapter 8, the danger of regulatory capture is always present.

The reduced accountability of the privatised sectors further carries negative implications for the environment. In the same way that societal concerns do not bear on private entrepreneurs, neither do environmental concerns. This is especially relevant in the case of industry and of the network industries. As shown in Chapter 8, the investment decisions of private entrepreneurs are mostly guided by short-term considerations, at the expense of the environment.

Lastly, the global financial crisis of 2007/2008 serves to stress the significance of accountability as a necessary component of a stable economy and a just society. In particular, the privatisation and liberalisation of the financial sector gave rise to a strong moral hazard effect, leading to the collapse of giant corporations and leaving the world aghast at the malfeasance of private enterprise.

Overall, after nearly thirty years of privatisation and liberalisation, the allegation that the economic and social consequences of privatisation were positive for the majority of people are not corroborated and in many cases are rejected by empirical evidence. This is only to be expected, since (1) their economic impact is at best contested; (2) their social implications are negative, to the extent that they tend to divide society into the 'haves' and 'have-nots'; while (3) their impact on the democratic process and on the political system has been to reduce accountability.

13.5 Summary and conclusions

In this chapter, we looked at different aspects of the privatisation and liberalisation trajectories in Europe. Our observations – summarised below – are based on a cross-sector view, derived from the case studies presented in the preceding chapters of Part II.

- Essential to our understanding the process of privatisation and liberalisation is the shift in hegemonic paradigm, which occurred worldwide in the late 1970s and early 1980s. In Europe, this obtained additional momentum in the late 1980s and in the 1990s, as certain Europe-specific trends – namely, the single market and the single currency – became increasingly important.
- Such a shift in paradigm was underpinned by a change in the social relations in production, as new interest groups, mainly in the area of finance, acquired greater weight. At the same time, the ideological/political aspect of this change should not be underestimated. On the contrary, without such an ideological/political shift, it would not have been possible for neo-liberalism to capture Europe as decisively as it did.

- Further, what distinguishes the European experience of privatisation and liberalisation is the huge investment opportunities offered to international capital by the collapse of the economies of the CEEs, opening up new areas to the market mechanism. After the initial period, marked by radical adjustment and high levels of distress, most CEEs fell into step with Western European countries in the area of privatisation, so that a pattern of convergence may be discerned.
- The economic impact of privatisation and liberalisation is generally considered to be ambivalent. The superiority of private enterprise vis-à-vis the state has not been conclusively proven, while it has been shown to be theoretically unsustainable on particular grounds.
- The social impact of privatisation, on the other hand, is generally perceived to have been harmful. Not only has privatisation explicitly aimed at creating a society of individuals, where the ties of solidarity are accordingly weakened, but it has also resulted in social divisions becoming deeper and thus more difficult to overcome.
- Politically, privatisation, as part of a neo-liberal set of policies, has led to the strengthening of particular, business interest groups at the expense of democratic accountability and control.

Overall, privatisation and liberalisation have been instrumental in reshaping Europe over the last quarter of the twentieth century. They have led to a more risk-prone economy and to a more unequal and vulnerable society. While the crisis of the late 2000s is working itself out through the European economic and social structures, neoliberalism appears to be retracting. Whether this signals the beginnings of a new paradigm shift will depend on a complexity of factors, including ideological and political ones.

References

Hall, D. (2005) “A Global Review of Multinational Corporations in the Water and Electricity Sectors”, *The Transnational Institute Public Services Overview*, 2005/2006, pp. 179–185.

Marrero, A. and Hernandez, F. (2005) “The Legacy of Recent Reforms: Privatisation and Deprivation”, *The Transnational Institute Public Services Overview*, 2005/2006, pp. 47–55.

Needham, C. (2005) “Private Choice versus Accountability and Equity”, *The Transnational Institute Public Services Overview*, 2005/2006, pp. 149–157.

Part III

Perspectives

14
The Impact of Privatisation and Liberalisation of Public Services on the European Social Model

Birgit Mahnkopf

14.1 Introduction

The struggle over the academic and political meaning of a European Social Model (ESM) is still ongoing. According to the Lisbon Strategy, the framework setting is intentionally left to the market actors. However, it is obvious that positive integration within the EU to a certain extent is a necessary complement to negative integration. Consequently, there seems to be an urgent need to throw sand into the transmission of the 'satanic mill' (Polany, 1978, p. 59) of deregulated markets. This should be the task of *another ESM* than the one announced on the summit of Lisbon 2000 and since then advertised by the EC.

In this chapter the impact of privatisation and liberalisation of public services on the very foundations of a European model of societal development will be discussed. The main conclusions of this chapter focus on the access to public services as the most important common denominator of an ESM: If universal and equal access to these services for a growing number of EU citizens is sacrificed for the goal of competitiveness, then an increase in social inequalities and social polarisation is unavoidable. Furthermore, citizens who might rightly fear losing control of development will disengage in democratic participation. In the end, this may lead to an erosion of political citizenship which will seriously endanger the process of European integration.

14.2 The common denominator of social models in Europe and the distinctive role of public services

Until the 1980s, social market economies in Western Europe where confidently set against the US model as an economically successful approach in the context of worldwide competition. This approach included: a *universal welfare state* based on social citizenship; *state intervention* to promote employment and redistribute income from the wealthy to the less well off so

that the state could function as an instrument for social balancing; mechanism of *non-market coordination* based on strong unions, an institutionalised compromise between labour and capital and managed labour market regulatory practices (Schulten, Brandt and Hermann, 2008); *public ownership of key economic sectors* (such as the public utilities) and *public services accessible to everyone,* established even as a right to health care, education and social security.

Unlike the US model of capitalism, and despite its numerous variations within Europe, a particular social model had developed after World War II that was viewed as being better placed than US jurisdiction to address social fragmentation, exclusion and inequality. In its most influential social democratic version, this model was based on the idea that capitalism and democracy were inextricably linked. Different welfare regimes were the answer to the demands of the underprivileged working classes, who did not want to just play a role as production factors in the labour market, but wanted to take part in the political arena of the nation-states as citizens and were given the institutionally regulated chances to do so. This *equality of the political status* accompanying the unequal or even antagonistic economic interests and social conditions formed the principle of communal life, of a common constitution, and of consented respect for political institutions (Marshall, 1950). The welfare state and its institutions thus became a vehicle of identity formation in the split societies in post-World War II Western Europe and therefore a guarantee for social peace. In some European countries, such as Germany, Austria or the Scandinavian countries, this social model even emerged into an economically based *productivity pact of labour and capital* and, with the support of state social policy, became a promoter of growth and democracy (Mahnkopf, 1999). However, in all Western European countries social cohesion within the borders of the nation-state – therefore usually excluding ‘those-who-do-not-belong’, mainly defined through nationality – and the drive towards essential democratisation has been based on the distinctive role of public services as part of the *public domain*.

At the pinnacle of European welfare regimes, the growth of social citizenship was a chief driver of the expansion of a large public sector which erected barriers against incursions from the market. With the extension of a public domain of citizenship, equity and service the market domain of buying and selling had shrunk correspondingly. “In the process, the state became the arbiter of the rules under which markets could flourish and the Keynesian public sphere became a privileged site where civil society was able to scrutinize the exercise of its power and authority” (Drache, 2001, p. 53). The state was using its unique powers to organise the provision of social goods and resolve problems of collective action that private property regimes with their short-term interests did not address. There was a common understanding across Europe that the market mechanism is in principle not capable of satisfying the needs of all people and cannot guarantee equal

living opportunities. Therefore, a vital cross-party and even cross-country consensus required that certain goods and services have to be excluded from the operating mechanism of the market. Subsidised public services, as well as affordable housing, public pension systems, basic infrastructures or a strong role and weight of the state in the banking sector were rather viewed as preconditions to realise economic, social, political and cultural rights. In particular, (non-pure) public goods such as education, health care, and access to cultural institutions were viewed as *goods of social value* (or *merit goods*) (Atkinson and Stiglitz, 1980; Musgrave, 1959) that are indispensable for a decent living on a historically given level.

With respect to *economic development* the prevention of wasteful competition between national providers of energy supply, postal, telegraph and telephone systems, supply and disposal of water, public transportation and so on was an important element of state policy. Although there was not a common pattern with regard to public ownership in the industrial sector, such a pattern existed with regard to public utilities. As such, this component of an ESM has served as an important mechanism to generate a good relationship between the market, social cohesion and democracy. Furthermore, a trade-off between social expenditures and costs for public security had been established, underlining what has been coined as the 'economic value of social policy'. Obviously, a high degree of socio-economic security for all citizens is correlated with lower costs for maintenance, control, punishment, and re-socialisation of people who came into conflict with legal forces. At the same time, comprehensive social security for all citizens heightened the motivation and the educational demands of all, and thus contributed to social, cultural, and technical innovations and increased the productivity of work.

In Europe, public services were strongly related to *social justice*, even if their economic efficiency proved to be lower than under market conditions. In particular, social services were provided to a wide spectrum of society, aimed at achieving *solidarity* and *social and territorial cohesion*. Furthermore, the provision, protection, and guaranteeing of the accessibility of 'merit goods' were (and still are) inseparably bound with the *political order* as a whole. A broadly shared consensus assumed that policy should enable all citizens to have equal opportunities to realise individually chosen life plans, as well as to access indispensable goods like water, a sound environment, safe energy supply, good roads, an efficient school system or carefully controlled financial systems. Due to the fact that in modern society, structures of direct solidarity by family, relatives and the neighbourhood have almost disappeared, redistribution systems of the welfare state counted as much as indispensable goods; they determine whether all citizens are guaranteed physical and psychological health, knowledge, information or mobility. Against this background, indispensable goods and services had become *social rights* in the European welfare states of the second half of the

twentieth century, if not *de jure* but *de facto*. This was the case even within (south) European countries where the welfare state has been rather weak.

In short, the provision of public services tied democracy to the effective expansion of economic, social, and cultural rights, which respond to the values *of equality, solidarity and non-discrimination*. Over time, the provision of goods and services that the particular societies considered to be provided for all its members had been broadened because of the influence they exercised on their capacities or on their welfare. With this background, making access to 'goods of social value' a reality whenever possible became an *ethical imperative* in most European countries. Whereas size and scope of public services always were a matter of political debate and a subject of the balance of power between the social classes.

14.3 The erosion of the ESM and its non-extension to CEE countries

Since the 1990s, the established welfare regimes in Western Europe have been increasingly blamed as being 'fossilised', inflexible and not open to innovations. But current debates over 'ways toward greater employment' did not centre on the 'catch up development' of the Swedish social model, which involves an expansion and an upgrading of the public service sector. Rather it focuses on a socially bearable version of *Americanised labour market and welfare policies*. It is increasingly argued that the post-war welfare regimes in Western Europe have to be reformed in order to strike a new balance between efficiency and social justice.

Surveys and opinion polls show that there still is a majority of Europeans in favour of public services to remain public or not being provided for profit. Nevertheless, the idea of a minimum, enabling, instead of a protecting, welfare state, functioning without a dense net of public enterprises and services, became a harsh reality. Across Europe this was the outcome of *reform-brainwashing* organised by supporters and propagandists of the neoliberal ideology with their campaign against the principle of solidarity. This principle has been successfully denounced through the networks of big media enterprises, employers associations, insurances and banks as well as economic research institutions. An important goal of the economic elites' agenda was to discredit the principle of solidarity as adequate governance for the coverage of societal risks. This is well known as a principle of 'asymmetric reciprocity', in which contributions are imposed according to capabilities of the individual, aid however is distributed according to the need. The market cannot offer such an asymmetric reciprocity because it reacts solely to the signal of purchasing power and capabilities. Therefore, the principle of solidarity has to be questioned; only then is it possible to supply the ageing societies in the EU with the increasing demand for health

care, education, care and social services through the markets and even regulate the demand through competition.

Neoliberal reform brainwashing was very successful, first in the UK under the Thatcher government, then during the period of transition in the Central and East European (CEE) countries, and finally it reversed post-war reforms in Western Europe. Rather than erasing a framework for the expansion of a ESM or even making the highest prevailing level of welfare provisions the norm throughout Europe, the system change in Eastern Europe rapidly started to have a "knock-on effect of pushing downward pressure on wages and welfare provisions in Western Europe" (Hudson, 1996, p. 64).

The IMF-endorsed policies being implemented in CEE countries on the one hand helped to improve economic performance, but on the other hand abolished what citizens grew up to accept as their social rights. Under the impact of 1989 and 1991, far from attempting to extend a Western ESM to Eastern Europe, both socialist and conservative governments in the transition countries showed a serious commitment to dismantling welfare provisions, deregulating employment and putting more emphasis on partnership between state funding of public services and private enterprises – after privatising industries, network facilities, hospitals and various educational institutions. Usually, citizens in the CEE countries did not reject these economic reforms, but rather showed impatience that they did not benefit more. Resistance against the privatisation of health care and education was rare in these countries except for criticism voiced by trade unions and pensioners who feared that pension funds, which were set up under the communist regime, could be used for commercial purposes after privatisation.

To a large extent, the fact that privatisation of public services in CEE countries has until recently been accepted without much resistance can be explained by the frustrating experiences of East Europeans with bureaucratic centralisation, top-down statism and often bad quality of public services under the state command economy. Against this background, the neoliberal "counter-revolution" (Friedman, 1983) proposed to offer a 'solution' for the provision of all kinds of public services lacking democratic accountability and transparency: The sovereign consumer was supposed to replace the dissatisfied and disillusioned citizen. In this respect, since the 1990s the situation in Western Europe is not that different. Across Europe the populist right play with a particular type of consumer identity that sets the population as consumer individuals – against the state, the tax system and the elite (see Marsdal, 2007).

Although the EU is not in the first instance responsible for the social regress in Europe, in particular the EU Commission was and still is a driving force of the neoliberal discourse which preceded and accompanied privatisation and liberalisation of public services across the continent (Bieling and Deckwirth, 2008). As a result, within the EU member states the political consensus and the social will to maintain its former commitment to

redistribution and a strong role for public services is increasingly lacking. Against this background, the *new ESM* which is pushed by the EU administration is not so much about a 'social Europe' but about subsuming the social to the economic model of 'Global Europe' (EC, 2006) which is fostered by the EC attempting (among others) to create (even artificial) markets in every area of social life.

This development is backed by the downsizing of the state aiming to withdraw its influence to the role of a facilitator for the most assertive interests of influential economic actors. Thus the EU member states are increasingly operating essentially in the way which was demanded from economic agents for the past two decades: as entrepreneurial, competitive institutions which create premises for the structural transformations embraced by the world market. Hence, it is accepted that macro-economic leeway as well as the possibilities for the protection of non-competitive production factors within the new framework conditions of globalisation are diminishing. But if neither governments nor the EU intervene in economic policy following other objectives than today's ever-prevailing objective of monetary and financial stability, then the social civil rights which represent the foundation of political equality are undermined. Even if social rights are maintained formally in a European framework of competition, the demands deriving from it will fall into open space. Then the *substantial welfare* state turns into a merely *formal constitutional state* (Gill, 1998).

As a result, all basic norms of a social model in Europe which guaranteed cohesion within the borders of the nation states are being pressurised: *First*, due to the rigid administration of public expenditures within the framework of the currency and economic union, public infrastructure facilities are sold – for the purpose of short-term income – to profit-oriented corporations and institutional investors (sometimes even far below market price); and with the comprehensive deregulation and liberalisation programs of the single market project, public services are exposed to internal marketisation and external liberalisation and privatisation. *Second*, under the pressure of deregulated financial markets, solidarity-based social systems in which citizens contribute according to their means (through either taxes or social insurances obligations) but receive support according to their needs are questioned. *Third*, the system of sector-wide collective agreements and (in some countries) the rights of codetermination are brought to falter. Even in those countries where these *three pillars of socio-economic security* guaranteed by the different welfare regimes of the past still exist, the security provided by these systems has been eroded to a point that the citizens can no longer rely on them for their future existence.

This is also the case in CEE countries where the dismantling of the social services offered by public authorities was legitimised (and somehow accepted by the public) as an important step to create a social system which would stimulate individuals and social groups towards assuming greater

responsibility for their own social situation. But as a foreseeable result, along with the cuts in social expenditures the governments' abstinence from influencing the level of wages or taxing capital adequately, social inequalities and poverty increase dramatically thus confronting relevant social groups with social insecurities they have never experienced before (see ILO, 2008; OECD, 2008).

14.4 The impact of privatisation of public services on social cohesion and democracy in the EU

For the vast majority of European citizens the neoliberal model is failing to deliver long-term benefits, either economically or socially.

Efficiency increases and cost reductions are promised, even if a look at countries with bigger contingents of private provisions shows that these promises are questionable or even false. As most sector studies provided in this book indicate, the impact of liberalisation, privatisation and marketisation on efficiency and the quality of services are either negative or doubtful.

In the network industries, liberalisation and privatisation has had the effect of replacing single, public monopolies with a larger number of private quasi-monopolies which have tended to reduce the accessibility of public services and have not always benefited the consumers. The notion of 'universal services' and the notion of 'economic services of general interests' which are replacing the wider notion of 'public services' are likely to reduce the scale of public services and might cause gradual abandonment of the social dimension of regulation.

With regard to social services, the negative impacts of privatisation and marketisation on a 'social Europe' which citizens hope for are even more destructive. These processes are changing what has been perceived as social rights into commodities. Fewer services will be provided, financed, regulated and/or controlled by the public. This translates into a considerable cut of the *social wage* and reinforces economic and social insecurities in times when unemployment, harsh working and living conditions and poverty are on the increase in one of the richest regions in the world. The effects on social equity are overwhelmingly negative since inequalities and social polarisation will increase further.

Furthermore, with the rules of competition and thus profit and shareholder value maximizing a restructuring of labour relations and a worsening of the conditions of employment are provoked. There is clear tendency towards social dumping inside the member states and among the countries, whereby companies and/or member states try to maintain an artificially competitive edge by lowering social protection standards. As far as this tendency impacts serious constraints on the role of trade unions undermining collective bargaining and employment agreements, an already broad

'consensus gap' is widening which is turning the EU into something very negative for the numerous 'losers' of enforced competition.

The reduction of public spending (particularly on health and education) has serious consequences for the gender order. While removing some of the labour market opportunities for women, the downsizing of public services usually means that home and reproductive work has to be done by women either in the home or as paid and outsourced work in the growing informal sector of care, performed by low-waged women – often with a migrant background (Lethbridge, 2007).

In addition, it becomes more and more difficult for the state to take political decisions in order to favour developments towards a more 'social Europe'. This could have a negative impact on social cohesion and the political status of social citizenship and finally could even endanger the democratic functioning of the Union.

14.4.1 The impact on social cohesion and the political status of social citizenship

The creation of markets in the EU rests upon the introduction of competition into public sector systems. While breaking down these systems into separate 'business' units usually the competition dynamic is animated by 'choices', be it parental or student choice in the education system, the choice between different health insurances and hospitals in the health system, choices to be made in privatised pension systems or among a growing number of private financial institutions, electricity or water companies. However, ordinary people are usually not in a position to assess risks accurately and select between the different services. Moreover, those who rely most on the provision of high-quality services are those who are least prepared to bargain on favourable conditions.

Concerning social security systems in particular, it is doubtful whether a (re)-privatisation will actually lead to a more efficient use of public funds and an increase of individual freedom. Private insurance against financial risks and the devaluation of human resources, which might be affected by financial and currency crises or by the long-term unemployment that are endemic in capitalistic societies, is simply impossible. Private providers of public services do not only want their costs to be covered but also want to make a profit. Consequently, they do not have any other option than to exclude the bad risks in order to lower the costs wherever this is possible. In the medium-term, this results in two-tier or multi-tier supply systems. People with bad risks will have to be prepared for big cuts in the quality of services.

Privatisation thus contributes not only to a new and deeper social divergence, but it will also lead to a cut-back in the quality of the public goods and services that remain in public responsibility because these will be produced only for the people in greatest needs and thus need not to be of high quality: services mainly for the poor are usually poor services. Only if the access to

public services is guaranteed as a social right and is available for all people through their status as citizens, including the well-to-do middle class, might there be pressure in favour of high standards and optimal supply.

Therefore, the widening of choices offered by privatisation and marketisation and the gradual replacement of social responsibility through competition and individual responsibility in practice is favourable only for the well-to-do. The 'choice issue' which is one of the main arguments in favour of privatisation, increases social, regional and gender inequalities. Furthermore, in phases of economic crises (such as the recent world financial and economic crisis), cumulative depression can have negative impacts; this is in particular the case in regard to private pension systems which are rind to procylicality of the financial sector. Therefore, in times of a crisis, not only social security for the poor is diminished, but social security for broad sections of the middle class living in a situation of precarious wealth is also affected.

Gradually public goods such as education, health care or social security in times of old age, sickness or unemployment shift from a resource the state owes to its citizens to a consumer product for which the individual must take responsibility. Thus, the *homo politicus* who has to communicate and organise with others for getting his or her rights is reduced to *homo oeconomicus* who has almost nothing in common with others. As a customer or a producer or investor he or she strives for his or her divergent interests. In the long run, this side-effect of liberalisation, deregulation and privatisation of public services may be damaging for social cohesion and the democratic system as a whole. This development being directly linked to the essence of privatisation can be judged as a *regress of a universalistic and law-based system to contractual, market-based relationships*. Market-based relationships do not exclude universalistic constructions by principle, but they create obstacles for the realisation of minimum social rights. Practically, all discussed and already initiated reforms of the social models in Europe and what so far takes shape as a new ESM have regressive effects favouring the well-to-do and bearing on the poorer population. Thus it seems to be the case that parallel to the discourse of a modernised ESM favoured by the EC, social cohesion within the enlarged EU is endangered instead of featuring a right-based sort of European identity. There seems to be a discernible tendency of Europe being 'Americanised'.

14.4.2 The impact on democratic participation

Liberalisation, privatisation and marketisation of public services is a stage in the evolution of capitalism that indicates a radical shift in the relations between state, society and private interests which seriously impacts democratic participation. While the state withdraws from control and administration of the services, *private sector actors* who hold no legitimacy to decide about future developments of the societies and do not allow for

participation in their decision-making process, change into the *role of a mediator of policy* between the central state and local as well as supranational institutions. In face of perceived European (and even global) homogenisation to a singular rationality of economic efficiency citizens rightly view that the specific social and cultural forces that underpin markets and are necessary for them to work properly are eroded. As a result, citizens increasingly fear that they may lose any control of development.

Ever more important experiences, events and needs in the lives of EU citizens are treated as problems of markets and thus outside the purview of politics. This contributes to the passivity and disengagement of large numbers of people and finally to an erosion of political citizenship. People increasingly relate to politics as an obscure and distasteful business utterly remote to their everyday lives. Detached from the issues of daily life, democracy becomes something purely formal lacking any substances by which people might govern themselves. As a result, participation in decision-making, which not only contributes to the well-being of people, but also is the most effective means by which to guarantee that the social objectives of development are adequately handled in public decisions (Sen, 1999), is declining. Not only will those citizens be excluded and marginalised from modern work, consumption and communication processes withdrawn from political processes and active citizenship, but also those new economic elites who until recently performed quite well in the market, will reduce their participation and active engagement in political affairs. While the excluded citizens will react with resignation, possibly also with anti-democratic rebellion, the new economic elite will regard former public services as 'positional goods' that promise a privileged status (for example higher education). Only where their own partial interests are at stake, will these people act politically.

Thus, the most important out of three options available for articulation and realisation of interests in democratic societies, according to Albert Hirschman (1970), will become meaningless: instead of using 'voice' (opposition) to highlight the undersupply of public services and so react politically, for economic beings there remains only the 'exit' option (to take refuge in other suppliers) for need satisfaction. The supply via the market mechanism takes place by 'buy-not buy' or 'pay-not pay'. This option is only available for those who have effective monetary purchasing power. For a democratic society, the difference is essential. Contrary to public service providers, private corporations are only accountable to their shareholders, not the citizens of the countries they invest in. If a public service provider does not satisfy the needs of its customers, who at the same time are the respective government's electorate, it might be replaced at the next electoral term. Whereas if a private provider, even more so a foreign private provider, fails to satisfy customers needs it cannot be that easily held accountable.

Neoliberalism from below, from those citizens who feel ignored and treated as second-class citizens may fit quite well with von Hayeks' (1944/2004) project of a constitution of liberty against any request of establishing some

rules of redistribution in Europe. However, for a European civil and political society to emerge *another ESM* is needed, preventing that a predominantly 'negative mode' of integration becomes a nightmare – for both EU citizens and its neighbours in the East and South.

14.5 Conclusion

An economic and social model is emerging in the EU that lacks most of the special characteristics which in former times had distinguished the different European welfare regimes from the US model. Although one could question the very existence of a specific European Social Model, from the viewpoint of its promoters such as OECD, World Bank, the EC, think tanks and lobby groups organizing corporate interests as well as the media, a 'new ESM' is on the rise. Within this 'non-model', from the viewpoint of European citizens, the role of the state is reduced to a contracting party and regulator which buy prepared 'good-enough solutions' for problems such as budgetary constraints, command bureaucracies and insufficient performance of service delivery. On the other hand, private corporations, without being legitimized to organise public policy, are increasingly providing not only funding for the public service itself, but even 'selling' policies (in education). Private companies might be viewed as 'mercenaries' making money out of the proliferation of a 'new ESM' based on privatisation of public services as a 'good enough', not 'best' solution for government problems in the age of global competition – for ever-lower corporate taxes, wages and costs.

If the idea of an ESM is to have any meaning to European citizens, a rebalancing of the EU agenda in favour of social and environmental concerns is of utmost importance. Both the Lisbon Agenda and the EU service directive are being used as crude instruments to attack valid and legitimate social legislation. However, in order to avoid further disintegration in the EU and a rebirth of nationalism, cooperation must become the driving force of development and common principles for public services should be established. This perspective requires public services to be provided in a way that these maintain a high degree of solidarity and create and strengthen social cohesion – through their high quality, continuity and security, and equal and universal access, affordable prices, efficiency and transparency.

References

Atkinson, A. B. and Stiglitz, J. (1980) *Lectures on Public Economics* (New York: Mc Graw Hill).

Bieling, H.-J. and Deckwirth, C. (2008) "Privatising Public Infrastructure Within the EU: The Interaction Between Suprainternational Institutions, Transnational Forces and National Governments", *Transfer*, Vol. 14, No. 2, pp. 237–257.

Drache, D. (2001) *The Market or the Public Domain?* (London & New York: Routledge).

European Commission (EC) (2006) *Global Europe Competing in the World. A Contribution to the EU's Growth and Jobs Strategy* (Brussels: DG Trade).

Friedman, M. (1983) *The Counter-Revolution in Monetary Theory* (London: Institute of Economic Affairs).

Gill, St. (1998) "European Governance & New Constitutionalism: EMU & Alternatives to Disciplinary Neo-Liberalisms in Europe", *New Political Economy*, Vol. 3, No. 1, pp. 5–26.

Hayek, Friedrich A. von (1944/2004) *Der Weg zur Knechtschaft* (Tübingen, Bd. 1, Abt. B der gesammelten Schriften von F. A. v. Hayek in deutscher Sprache, Hg. Manfred E. Streit).

Hirschman, A. O. (1970) *Exit, Voice and Loyalty* (Cambridge, MA: Harvard University Press).

Hudson, K. (1996) "Social Democracy and Post-Communism: The Hungarian Example", *Labour Focus on Eastern Europe,* Vol. 54, pp. 63–67.

ILO (2008) *World of Work Report 2008* (Geneva).

Lethbridge, J. (2007) *Multinational Care Company Expansion. Major Trends and Eligibility for European Works Councils* (report commissioned by EPSU), http://www.epsu.org

Mahnkopf, B. (1999) "Between the Devil and the Deep Blue Sea: The 'German Model' under the Pressure of Globalisation", in Panitch, L. and Leys, C. (eds) *Global Capitalism versus Democracy. Socialist Register 199* (London/New York: Merlin/ Monthley Review/ Fernwood), pp. 142–177.

Marsdal, Magnus (2007) *The FrP Code: The Secret Behind the Progress Party's Success* (New York: Manifest).

Marshall, T. H. (1950) *Citizenship and Social Class and Other Essays* (Cambridge: Cambridge University Press).

Musgrave, R. A. (1959) *The Theory of Public Finance* (Tokyo: Mc Graw Hill).

OECD (2008) *Growing Unequal?* (Paris).

Polany, K. (1978) *The Great Transformation. Politische und ökonomische Ursprünge von Gesellschaften und Wirtschaftssystemen* (Frankfurt: Main).

Schulten, Th., Brandt, Th. and Hermann, Ch. (2008) "Liberalisation and Privatisation of Public Services and Strategic Options for European Trade Unions", *Transfer*, Vol. 14, No. 2, pp. 295–311.

Sen, A. (1999) *Development as Freedom* (New York: Alfred A. Knopf).

15
Elements of a Progressive European Social Model

Christoph Hermann

15.1 Introduction

Preceding chapters have analysed in great detail the consequences of privatisation of public services and have thereby shown how privatisation undermines the very foundations of the European Social Model (ESM). This chapter attempts to go a step further and discuss possible elements of a progressive ESM as an alternative to the changes described in the previous pages. However, the starting point is an acknowledgement that although privatisation and related processes resulted in a situation that in many aspects is clearly inferior to the state where services were still provided publicly, a progressive alternative cannot simply demand for a reinstatement of the old model. First, the European social models of the post-war years themselves had a number of serious deficiencies, and second there are new challenges ahead that demand new responses.

There is no point in denying that the delivery of public services in the post-war years was not without problems. Even if privatisation made things worse, services users were not always satisfied with the services provided by bureaucratic, state-run and often seriously underfunded organisations. Similarly, there were plenty of loopholes in welfare safety nets, and some groups of individuals were plainly excluded, while welfare recipients were frequently treated in a paternalistic and perhaps even penalising manner. Given this legacy, it should not surprise that liberalisation and privatisation was not utterly rejected by service users who had hoped for the improvements promised by privatisation advocates (and hence were deeply frustrated by the subsequent developments). In formulating progressive elements of a new ESM, this chapter will therefore not only argue for a revocation of privatisation and related processes but also address some of the legitimate criticisms directed at the post-war social models.

15.2 An active role for the state

With the policy of liberalisation and privatisation the role of the state has changed profoundly in the past decades. During the post-war decades states actively engaged in the provision of public services through widespread public ownership and through the adaptation of encompassing and detailed service regulations (starting with provisions for investments and ending with the imposition of prices and tariffs). In contrast, in recent years European governments tend to leave the provision of public services to private companies and the 'free play' of market forces (Hermann and Verhoest, 2008). While the primary objective of private companies, regardless whether they provide public or private goods, is to generate profits (and for this purpose they are willing to compromise accessibility and service quality if not barred from doing so), the role of the state is reduced to making sure that competing providers have access to the markets (ibid.). In some sectors, certain providers are subjected to universal or public service obligations, but these usually apply only to one provider, typically the former monopoly supplier, while the others are free to provide the same services at their own discretion. Not surprisingly, this creates tensions between those who are forced to maintain a certain quantity and quality of service provision and others who can focus on particular lucrative areas or business segments. In addition, despite the opening of public service markets, competition is still limited with public monopolies often being replaced by private oligopolies (ibid.). In other cases, in particular in services in which competition between different providers is dysfunctional (e.g., public transport), or which are heavily subsidized (e.g., education and health services), the provision is not simply left to the free play of market forces. In these cases, states increasingly engage private providers through contracting, 'private-public partnerships' or 'private finance initiatives'.

Private-sector involvement, according to the rationale behind this tendency, allegedly makes service provision more effective and efficient and therefore less costly. As described in detail in the second part of the book, private sector involvement has, in contrast, often increased costs, while deteriorating quality, and obstructing responsibility, accountability and transparency. In short, in the liberalised and privatised public service model choice between competing providers, who mostly offer the same or only marginally different services, has replaced democratic accountability (Le Grand, 2007). Yet, as we will discuss further below, choice has resonated well among many public service users precisely because of weak responsiveness and limited democratic accountability in the governance of public services, both in Western European welfare and Eastern European communist states. However, the cost-cutting argument not only amplified the role of private companies in public service provision. Even where services are still provided by government agencies, the nature of service provision has been altered through

the introduction of new public management techniques, emulating private sector goals and methods (Needham, 2007; Whitfield, 2001). Changes have been described as a shift from 'welfare' to 'contracting' or 'enabling states' (Gilbert, 2002). It is important to note that governments do not necessarily cede power in this process. What instead happens is a transformation of the role and responsibility of states. Some authors have therefore described the transformation as a move towards 'competition states' (Hirsch, 2005), emphasising the increasing state support for private businesses.

A progressive ESM needs an active state that fully resumes its responsibilities vis-à-vis its citizens. Instead of hoping that the 'free' play of market forces will create favourable outcomes (which it more often does not than it does), public authorities have to make sure that the outcomes meet the needs and expectations of citizens. While not all services must be provided by public organisations – private for-profit and not-for-profit organisations have always played an important role in the provision of public services in some countries and sectors – comprehensive regulation must guarantee that profit interests are subordinated to the interests of citizens. This means that regulation must cover the whole process of service provision (from investments to prices and tariffs) not only specific aspects (such as, for example, the access of competing providers to infrastructure). Similarly important, regulation should not be limited to certain providers, but cover all companies that are engaged in the provision of public services. Service users and citizens more generally, should play an active role in the design of regulation and the monitoring of compliance (Palast, Oppenheim and McGregor, 2003). This means that a progressive ESM not only needs a more active but also a more democratic state (Albo, Langille and Panitch, 1993).

Although comprehensive regulation is an important step in reinstating responsibility and accountability, public ownership still has an additional advantage as it enables governments to directly intervene and actively respond to changing needs and expectations, and even more importantly, to build the capacity for public problem-solving processes, thereby limiting the dependence on the private sector (which, as the current financial crisis shows, is of crucial importance). In a similar vein, public ownership enables the state to promote innovations and developments that go beyond the initiative of private capital with short-term profit expectations. This is particular important for long-term investments in improving environmental sustainability. While the recent financial crisis has led to a number of public takeovers of failing private banks, other forms of re-nationalisation in Europe have been rare. Among the rare cases are a number of municipalities who have brought some of the outsourced services back under municipal ownership after sometimes disastrous experiences with private contractors (Candeias, Rilling and Weise, 2008; Needham, 2008).

To be able to meet their responsibilities, states, of course, need sufficient financial resources. Tax policies therefore play a crucial role in a progressive

ESM. Only through a meaningful and progressive tax policy can states make sure that the public sector is sufficiently funded to deliver those services that citizens are expecting. The current trend of granting tax breaks to the rich has exactly the opposite effect and deprives states from the possibility to sufficiently fund public services. In several sectors and countries it was problems created by underfunding that paved the way for privatisation as service users were discontented by deteriorating infrastructure and service quality while the new private owners promised long-overdue investments (in some cases, however, investments were also made before the public companies were sold to private investors). Underfunding of public services and deteriorating infrastructures are particular pressing problems in the new member states in Central and Eastern Europe where governments are severely constrained by their attempts to join the Euro area. In Western Europe similar pressures are felt by municipalities who are subjected to increasingly tight deficit targets by federal governments who themselves attempt to meet the Growth and Stability Pact Criteria. Hence, a progressive ESM with flourishing public services not only needs supportive tax but also monetary policies.

15.3 An encompassing welfare system and the decommodification of social relations

Originally, welfare systems were developed to protect citizens from the risks and distortions inherent to modern market societies and the wage labour status. Welfare systems provided income for the unemployed, disabled, for those who are too old to work or are poor for other reasons. True, there were loopholes in social protection and only the most advanced welfare states provided a decent basic income, but welfare was based on social rights and not on charity. This implied the acceptance of redistribution of wealth through a progressive tax policy and proportional social security contributions. Consequently, as Gøsta Esping-Anderson (1990) has pointed out, even the most conservative welfare systems contained some degree of decommodification.

In very basic terms, decommodification means that citizens are not dependent on income generated by the sale of their labour power and the subsequent exchange of money for goods and services in order to exist. Labour law and collective agreements also play an important role in this regard as they establish rules and responsibilities associated with the purchase of labour power and thereby restrict labours' commodity character (Hyman, 2005). Decommodification went furthest in the northern European welfare states where welfare not only meant cash transfers to those eligible for benefits, but the development of a public infrastructure, with child care facilities and elderly care structures, among other things, that not only provided help for those in need, but also job opportunities for

workers excluded from or disadvantaged on private sector labour markets, including, most notably, women. It also shows the importance of welfare policy for the promotion of equal opportunities and for combating discrimination (Heintze, 2005). Regardless of the national welfare model, there was widespread consensus among European policymakers during the post-war decades that welfare systems must continuously be improved to strengthen solidarity and social cohesion.

Recent decades of welfare and labour market reforms have reversed this development and significantly reduced the level of decommodification. Instead of allowing for an existence beyond the market and money-driven society, welfare benefits are increasingly targeted towards integrating those without employment as fast as possible into the labour market. Of course there is nothing wrong with supporting unemployed workers to find a job, but not by forcing them to accept any employment that is available including poorly paid and precarious work (Gray, 2004). Some authors have described these changes as shift from welfare to workfare policies (Peck, 2001). In this process, fundamental social rights are reduced to temporary and conditional support and anti-discrimination strategies are confined to labour market policies, although recent welfare and labour market reforms fuel inequality and social exclusion.

Instead of forcing an increasing number of European citizens in the ranks of the working poor and precarious workers, a progressive and comprehensive welfare policy should start with governments developing an active macro-policy as an essential part of a progressive welfare strategy. The same governments that promote workfare policies have become increasingly reluctant to stimulate the overall economy. Second, a progressive and comprehensive welfare policy is hard to be imagined without a meaningful redistribution of wealth. Tax cuts for the rich typically mean welfare cuts for the poor. In contrast, a comprehensive welfare policy must reinstate the principle of solidarity (everybody gives what he or she can, and takes what he or she needs).

Measures to fight poverty include the introduction of an adequate European minimum wage and the granting of a general basic income that allows for a decent social existence. While the first measure is supposed to make sure that even the lowest paid jobs pay for a living, the latter is meant to protect workers from having to accept jobs with poor employment and working conditions. In addition it is an acknowledgment of the existence and decisive role of unpaid labour in the reproduction of European families, and, consequently, for social cohesion and progress. The form and eligibility of the basic income must be designed to make sure that state agencies cannot treat welfare recipients paternalistically. To strengthen the decommodifying effects of such a measure, monetary transfers should be combined with the creation of what some authors have called a social infrastructure. As Joachim Hirsch (2007, p. 143) explains, "the goal should be to establish

a comprehensive social infrastructure, which combines an expanded provision of public goods with an adequate and unconditioned and for everybody available basic income, which not only secures the material existence but enables self-development and participation in society."

A progressive welfare policy should not be limited to particular and presumably comparably rich member states. These countries should maintain and strengthen their welfare regimes, but, in order to allow poorer countries within the European Union to narrow the gap in welfare standards, a common set of welfare benefits should be statutorily established for all member states, even if the material levels of the benefits would be related to living costs in the respective countries. To advance in that process, institutions such as the European Social Fund (ESF) could play a critical role, but must be endowed with sufficient resources and powers. A trend towards convergence of welfare benefits is a basic element towards equality, regional development and social cohesion, and it could substantially reinforce the sense of European citizenship.

15.4 Equality and equal opportunities through accessibility, affordability and high quality public services

Although there is a wide range of public services, one of their common feature is that they provide citizens with essential means of existence and that in contrast to private services individual purchasing power has only a limited effect on the quality and quantity of the services provided. For this reason, public services are particularly important to sustain equality and social cohesion. While some services were freely accessible (e.g., health care, education), for others a fee or price was charged even in the past (e.g., transport or electricity). However, price policy was typically the result of political decisions rather than of market processes. As such, prices were frequently subsidised. In the case of multi-service suppliers, loss-making services were sometimes subsidised by the profit-making activities of the same organisation (e.g., post by telecommunication). Hence, even if services were not freely accessible, prices reflected social concerns in order to make sure that low-income groups were not excluded.

Liberalisation and privatisation advocates have criticised this as illegitimate and costly interference in market processes which ultimately results in higher costs. Liberalisation and privatisation according to this view will reduce prices and thereby improve accessibility. In reality, however, liberalisation and privatisation has led to the establishment of complex and often intransparent price structures with different prices for different groups of users. This not only makes it difficult to compare prices and thereby obstructs competition, but new price structures tend to favour large customers with strong market power, often being large corporations that subsequently profit

from liberalisation and privatisation, while for small companies or private households prices decreased only marginally. And sometimes they have even increased. As a result, liberalisation and privatisation has fuelled inequality and partly undermined accessibility, even if the average price for a particular service may have decreased. The introduction of variable fees had similar effects: Private health care insurances advantage high-income groups as these customers typically show lower health risks and therefore qualify for lower premiums than low-income earners. Other fees may be the same for all users but they may create a serious barrier for low-income earners to use the service as they make up for a significantly larger proportion of their income than for high-income earners.

In extreme cases, liberalisation and privatisation can cause the emergence of two-tier systems for high- and low-income earners as is already the case in the health care systems in the new member states in Central and Eastern Europe, with public hospitals treating low-income earners and private hospitals treating those who can afford private insurance or have sufficient personal funds. This is a particular frightening development. A high quality of public services, as promised by the European Council and the European Commission, can only be sustained as long as low- and high-income earners use the same services. Experience shows that services for the poor are typically poor services (see Chapter 14). Yet the growing attention paid to more profitable customers or service areas is a general problem that threatens to undermine the quality and accessibility of service provision. While universal service provides (e.g., former national post companies) are obliged to maintain a national distribution network that more or less covers the entire territory and provides a whole range of services, new competitors can concentrate on certain areas (e.g., highly populated urban centres) and particular lucrative costumers (e.g., large corporations with a large amount of mail). As a result, universal service providers feel even more pressure to cut costs and one way to do this is to cut-back on services (as can, for example, be seen in the repeated closures of railways and post offices in rural areas).

Liberalisation and privatisation is not only believed to result in falling prices, their advocates also assume that competition makes sure that service providers improve service quality. Indeed some public service companies have responded to competition by stepping-up customer service relations and by introducing specific quality control systems (Flecker and Hermann, 2009). However, quality standards are deliberately chosen not to contradict with cost-cutting programmes with the effect that broader quality criteria such as the well-being of the service user or of the local community are neglected. Moreover, a number of public services are particularly labour intensive. In these kind of services, the reduction of employment introduced to prepare former monopoly providers for competition (even though competition often increased only marginally) and the poor working conditions

offered by the new competitors very likely have a negative impact on service quality (ibid.).

To guarantee accessible, affordable high-quality services, regulation should not only introduce universal service obligations for all providers, but also impose common quality standards developed in cooperation with user groups. Services should, furthermore, as far as possible be freely accessible, but if prices or tariffs are charged these should reflect social and environmental concerns and not be left to market processes. The objective is to make sure that all citizens, however marginalised socially or geographically, have sufficient service access. In addition, price policy should take into account the long-term effects of a possible exclusion of certain groups from service provision, which may greatly outstrip the initial costs (as it is obviously the case in health and educational services). The establishment of socially and environmentally sensitive prices of course demands the possibility to subsidise services.

15.5 High quality public sector jobs in order to ensure high quality services

The quality and effectiveness of public services depends on highly motivated public sector workers with sufficient resources and training to accomplish their tasks. Moreover, public services are also a major source of jobs. Public service providers are among the largest employers in their countries. During the post-war decades the extension of public employment played an important role in reaching the overall objective of full employment and in mitigating cyclical private sector job losses. It not only created employment opportunities especially for low- and medium-skilled workers and in some areas for women, but also worked as a counterweight and partly as a model for the private sector employment regime (Schulten, Brandt and Hermann, 2008).

Many public sector workers enjoyed a high degree of employment security, while working conditions were regulated by a complex set of rules which made sure that economic pressure did not compromise quality and security of services. As a result, employment and working conditions were more stable and homogenous than those offered by private sector employers, thereby adding to the decommodification of labour in the post-war decades (ibid.). Public sector workers were subsequently less motivated by wage increases than by the public sector ethos, including a high degree of identification with the employing organisation, loyalty, accountability, a sense of community and a sense of justice. In some cases there was, however, also a lack of motivation.

Liberalisation and privatisation presented a major challenge to the public sector employment regime. Allegedly, rigid employment standards and work rules, including a lifetime protection from dismissal, were criticised as barriers to greater service efficiency. In some countries (like the UK) and sectors

liberalisation and privatisation were deliberately deployed by governments to break the power of public sector trade unions. Cost-cutting has not only led to falling employment numbers; the emergence of new competitors and the drive to lower labour costs have at the same time resulted in a fragmentation of bargaining structures and the introduction of two- and multi-tier labour relation systems (Brandt and Schulten, 2007). Differences emerged between 'old' and 'new' workers in the same company, between workers employed by the former monopoly providers and by the new competitors and between in-house and outsourced staff. Liberalisation and privatisation have not only led to a widespread deterioration of public sector working conditions, in a number of cases they have literally fuelled the creation of low-paid and precarious jobs (e.g., in the postal sector in Germany and the Netherlands). The resulting re-commodification of public sector employment may not only affect public sector workers. In the absence of a public sector counter-weight, private sector employees in the long term can also expect growing pressure on wages and working conditions.

To make sure that liberalisation and privatisation are not carried out at the cost of public sector workers and of service quality (suffering from poor employment and working conditions) there is a need for strong and encompassing employment standards in public service sectors. These standards have to create a level playing field that applies to all competitors, not only to the former monopoly providers, and should make sure that workers who carry out the same job should receive the same compensation. In addition, new competitors should be banned from fighting unionisation and required to introduce the same forms of workers' representation that exist in the former monopoly providers (who typically have elected works councils and much higher union membership rates than the new competitors). Training and promotion systems should be fair and profit all public sector workers and not only particular groups. Wage differentials should be based on experience and commitment and not on market criteria and they should be proportional in order to strengthen the solidarity between public sector workers.

Besides trade unions, work councils and other forms of labour representation should play an important and active role in the planning and delivery of public services. A highly motivated public sector workforce is the best guarantee that service quality is improved in a great variety of aspects, including those that are particularly labour intensive. In addition, the public sector should provide extensive training and comparable decent jobs, especially for low- and medium-skilled workers, and for workers who are discriminated in private sector labour markets.

15.6 More participation, accountability and sustainability

A paramount element in a progressive ESM is to make political decision making of any kind, particularly relating to welfare, much more participatory.

A reform of the ESM must therefore centre on improving participation, accountability and sustainability. This will be the critical difference to the social models of the post-war years. In other words, social and political institutions and states themselves must change and allow for new forms of activism, participation and responsiveness in order to overcome the paternalistic top-down governance structures of the Keynesian welfare states of Western Europe and the state-communist systems of Eastern Europe. A radical democratisation of European societies that promotes active participation also demands for citizens with sufficient resources to formulate and articulate their expectations, and engage in the development of collective solutions to social problems. It is clear that the financing of this new system must be public, but the concrete processes and institutions that enable a radical democratisation still wait to be developed. Participatory budgeting developed in South America, but increasingly also practiced in European municipalities is one example of how state agencies can be made more responsive to citizens' needs.

Public services play a crucial role in this regard and the reform of public services could function as a model for a penetrating democratisation of European societies. In the old public service model citizens elected governments which would then decide about the provision of public services or delegate decisions to administrative units. If they were not satisfied with the services, users could elect another government but they could not directly articulate their critique of existing practices. However, with liberalisation and privatisation and the resulting commodification of public service provision service users have even less influence. In the new privatised social models the provision of 'public' services is left to the market which means that service users have a choice to decide between two or more providers that perhaps all provide the same unsatisfying service – if they can afford to pay for them. Instead of reducing service users to consumers that can choose between different yet unsatisfying alternatives, an alternative public service model should be based on strong and encompassing user participation.

The participation should bet twofold: First of all, users should be encouraged to monitor service delivery and make suggestions for improvements. Second, service users or specifically assigned user representatives should play an important role in the planning and design of public services. Service users, in other words, should become co-producers (Needham, 2008). A possibility would be the installation of a wide range of public service boards with representatives from management, workers, experts and service users. The objective would not only be to solve current problems, but also to develop a dialog and vision for the future of public services. There are some examples that give a hint how such a dialog could work. The reorganisation of municipal services in Trondheim in Norway clearly demonstrates the gains involved in such a process (Little, 2007). Yet the example of Trondheim also shows that the primary focus of public service reform should not be how to cut costs, but how to improve services.

15.7 Conclusion

The elements of a progressive ESM identified and discussed in this chapter are certainly important but not exhaustive. These elements are:

- An active yet more responsive and democratic state that resumes its responsibilities vis-à-vis its citizens. Such a state should introduce encompassing regulation that covers the entire process of service provision and makes sure that services are of high quality and easily accessible. An active state should furthermore promote public ownership in public services in order to built capacity for public problem-solving processes and innovation. To be able to do so, states need an adequate tax and monetary policy.
- An encompassing welfare system based on universal rights that enhance decommodification and protect workers from poor jobs and working conditions. Such a system should also guarantee a basic income for those outside paid employment, many of whom do unpaid work, in order to promote self-development and participation. Money transfers should be combined with a social infrastructure of high-quality, easily accessible public services. Such a welfare system can hardly be imagined without a meaningful distribution of wealth.
- Public services that are of high quality, accessible and affordable and thereby promote equality and social cohesion. As far as possible, public services should be freely accessible but if prices or tariffs are charged they should reflect social and environmental concerns, rather than reflecting market power of particular groups of costumers. In short, services should be the same for all service users regardless of their purchasing power. To make sure that all services are of high quality, regulation should address the various quality aspects involved in the provision of public services and cover all services providers not only the former monopoly suppliers.
- A public sector workforce which creates decent jobs especially for low- and medium-skilled workers and for groups that are discriminated against in private sector labour markets. Regulation should make sure that liberalisation and privatisation does not lead to a fragmentation of labour relations and a deterioration of employment and working conditions. Furthermore, trade unions, work councils and other forms of labour presentation should play an active role in the planning and delivery of public services.
- A high level of participation, accountability and sustainability. This is perhaps the greatest difference to the post-war models and the Western European welfare states and the Eastern European communist systems. Public services that constantly strive to meet the changing needs of citizens' demand for an active role of service users, both, in monitoring existing services and in the planning and designing of new services. Although there is much work ahead in developing institution and mechanisms that promote accountability and participation, there are a few examples in Europe that can be used as an inspiration to build a progressive ESM.

References

Albo, G., Langille, D. and Panitch, L. (eds) (1993) *A Different Kind of State? Popular Power and Democratic Administration* (Toronto: Oxford University Press).

Brandt, T. and Schulten, T. (2008) *The Impact of Liberalisation and Privatisation on Labour Relations* (PIQUE Policy Paper 2), http://www.pique.at/reports/pubs/PIQUE_PP2_15_10_2008.pdf

Candeias, M., Rilling, R. and Weise, K. (2008) "Krise der Privatisierung – Rückkehr des Öffentlichen", *WSI-Mitteilungen*, Vol. 10, pp. 563–569.

Esping-Andersen, G. (1990) *Three Worlds of Welfare Capitalism* (Princeton, NJ: Princeton University Press).

Flecker, J. and Hermann, C. (2009) *Liberalisation and Privatisation of Public Services – Company Reactions* (PIQUE Policy Paper 4), http://www.pique.at

Gilbert, N. (2002) *The Transformation of the Welfare State. The Silent Surrender of Public Responsibility* (Oxford: Oxford University Press).

Gray, A. (2004) *Unsocial Europe. Social Protection or Flexploitation?* (London: Pluto Press).

Heintze, C. (2005) *Wohlfahrtsstaat als Standortvorteil. Deutschlands Reformierweg im Lichte des skandinavischen Erfolgsmodells* (Berlin: Rosa-Luxemburg-Stiftung, Texte zur politischen Bildung – Heft 33).

Hermann, C. and Verhoest, K. (2008) *Varieties and Variations of Public Service Liberalisation and Privatisation* (PIQUE Policy Paper 1), http://www.pique.at/reports/pubs/PIQUE_PP1_15_10_2008.pdf

Hirsch, J. (2005) *Materialistische Staatstheorie Transformationsprozesse des kapitalistischen Staatensystems* (Hamburg: VSA Verlag).

Hirsch, J. (2007) "Der Kampf um öffentliche Güter – oder weshalb der Ausbau einer sozialen Infrastruktur nötig ist" in Klautke, R. and Oehrlein, B. (eds), *Pekarität – Neoliberalismus – Deregulierung* (Hamburg: VSA Verlag), pp. 137–146.

Hyman, R. (2005) "Trade Unions and the Politics of the European Social Model", *Economic and Industrial Democracy*, Vol. 26, No. 1, pp. 9–40.

Le Grand, J. (2007) *The Other Invisible Hand: Delivering Public Services Through Choice and Competition* (Princeton, NJ: Princeton University Press).

Little, M. (2007) "Look to Trondheim: Alternatives to Public Sector Reform in Europe", *Eurotopia*, May, http://www.tni.org/detail_page.phtml?&act_id=16819

Needham, C. (2007) *The Reform of Public Services under New Labour: Narratives of Consumerism* (Houndmills, Basingstoke, Hamsphire: Palgrave MacMillan).

Needham, C. (2008) "Citizens, Consumers and Co-Producers' ", *Kurswechsel*, Vol. 2, pp. 7–16.

Palast, G., Oppenheim, J. and MacGregor, T. (2003) *Democracy and Regulation: How the Public can Govern Privatised Essential Services* (London: Pluto Press).

Peck, J. (2001) *Workfare States* (New York: Guilford Press).

Schulten T., Brandt, T. and Hermann, C. (2008) "Liberalisation and Privatisation of Public Services and Strategic Options for European Trade Unions", *Transfer*, Vol. 14, No. 2, Summer, pp. 295–311.

Whitfield, T. (2001) Public Service or Corporate Welfare. Rethinking the National State in the Global Economy (London: Pluto Press).

16

The Role of the Public Sector in a Progressive Construction of Europe

Jörg Huffschmid and Jacques Mazier

16.1 Introduction

The dominant role of markets, competition and private profit as the regulating mechanisms of economic and social reproduction has during the last years been challenged for theoretical reasons and on the basis of empirical evidence. This raises the question of alternative frameworks and tools for a more democratic and sustainable development. *In this chapter, we present and discuss the public sector as a strong and indispensable pillar for a progressive European Social Model (ESM).* Its role should be revitalised on the local, regional and national level, and it should be established on the European level.

We use the term public sector in a narrow sense: It includes state-owned enterprises and public authorities which provide goods and services on a not-for-profit basis. We will first explain the importance of the public sector for a strong economy, for social cohesion and for a democratic society (Section 16.2), and then consider some problems of democratic management and criteria for the 'efficiency' of the public sector (Section 16.3). In Section 16.4 we explore the perspectives (and limits) of a European public sector. The concluding remarks in Section 16.5 relate to the necessary embedding of the public sector in a comprehensive and democratically controlled macroeconomic and fiscal environment.

16.2 The role of the public sector for economic development, social inclusion and political democracy

A new mixed economy and a public sector for strong and sustainable development

The political focus on liberalisation and competition-driven economic development has in most countries led to the erosion of infrastructure, sector-specific imbalances, regional and local disparities and growing international disequilibria, which all bear the risk of economic crisis and political conflicts. As a correction and alternative, the set-up of a *new mixed economy*

should be envisaged in which the main directions for the development of a productive, sustainable, and balanced economy are controlled by, on the one hand, a stronger macroeconomic and structural guidance of the private sector, and, on the other hand, the use of state-owned enterprises and public services. Experience shows that the provision of public goods and services through political regulation of private activities becomes increasingly difficult and expensive, and tensions between the quest for private profit and provision of public goods tend to increase with time as in the case of network industries (see Chapters 7 and 8). Therefore, a stop and reversal of the wave of privatisations and the re-nationalisation of network or infrastructure providers should be set on the agenda of economic policy. State-owned enterprises which are embedded in a progressive economic policy can be cornerstones for large state programmes to stabilise macroeconomic development. They are the core of industrial policies and the guarantee for the implementation of regional and structural policies (see Whitfield, 2001, chapter 8); and they can play a crucial role in the necessary restructuring of the economy in a more ecologically sustainable direction, like the development of public railways and other transport services or the development and promotion of new systems of energy generation and provision based on renewable energy sources.

The financial crisis that started in 2007 has also raised the problem of state-ownership of banks and other financial institutions. Governments and politicians of all orientations have during the year 2008 again and again underlined the public good character of financial stability which has been undermined through the private financial sector in the main centres of the world. Instead of bailing the sector out and subsidising it with fresh capital without controlling power, it would be appropriate to nationalise the leading banks and change their business model with concentration on securing a smooth payment system, sufficient provision of credit and safe deposits.

Public firms could and should also set standards for good working conditions and wage development. Lastly, public institutions for research and innovation are key instruments to secure a long-term development strategy.

The public sector and social inclusion Inclusiveness and solidarity as essential elements of a progressive European social model require the protection against the various risks within a capitalist society which cannot be avoided on the basis of individual activities, and the unrestricted and affordable access to social, cultural and other services which define the general social living standard (see Heintze and Lehndorff, 2009). These are unconditional social rights for every citizen or resident. To achieve these objectives the public sector is of eminent importance:

- To avoid or minimise unemployment a determined *macroeconomic policy for full employmen*t is the most important tool. To maximise the

employment effects public investment programmes are more efficient than stimulation of private investment through tax cuts or other subsidies. The most direct and efficient measure is a high share of employment in the public sector, where there has been a continuous reduction of employment during the last 20 years in most state members of the E.U. Through the implementation of additional public works the level of employment can be counter-cyclically adjusted throughout the business cycle. In order to avoid the creation of precarious employment, high standards in payment and working conditions should be maintained. Public training and education programmes should aim at a swift reintegration of the temporarily unemployed into decent jobs.

- Comprehensive *public health* systems should be in place for everyone regardless of his or her social status. Health and health care are not commodities with a market price but citizens rights, the costs for which must be borne by the society. Commercialisation of health care and privatisation of hospitals should be resisted, and the pharmaceutical industry should be nationalised in order to finance public health systems.
- The recent financial crisis has underlined the enormous risks for the elderly inherent in (completely or partly) private capital-based pension systems. A *life in dignity after retirement* is a cornerstone of the ESM and a social responsibility which cannot be delegated to financial markets. Furthermore, private pension systems which must spend much to market their products and which strive for profits are much more expensive and much less comprehensive than public ones. For both reasons it is imperative that pension systems should take the form of pay-as-you-go systems and be managed by public authorities. At the same time, these authorities must become more transparent and accessible for the individual employee and pensioner.
- Poverty is unacceptable and avoidable, particularly in developed societies, and it is a main element of social exclusion. Apart from an efficient system of public transfers, the public sector can contribute to the avoidance of poverty through decent wages for workers and employees which set standards also for the private sector.
- Universal and affordable access to modern services also relate to a bundle of services which together define the level of general societal development and enable people to participate in social life. These begin with childcare and include, for example, health care and other social services, educational services on all levels and for all ages (free school and university access and provision of the necessary equipment, textbooks and so on); cultural and recreational services and facilities (theatres, museums, parks, swimming pools and so on); communication services (postal services, telecommunication, transport and so on); other network services (electricity, gas, water); basic financial services (free bank account, bank card, certain number of transfers and so on) as the basis for monetary social inclusion; housing and residential facilities corresponding to the

citizens right to a decent home; public housing should be revitalised and combined with urban restructuring and development policies.

These services all belong (to varying degrees) to the heritage of the different societies in Europe. Most of them have been developed in the public sector and were provided for free or at low prices and fees. In the last two decades, they experienced a process of modernisation and differentiation (corresponding to the differentiation of individual preferences, sometimes generating segmentations). The simultaneous process of commercialisation has often led to privatisation (with or without regulation), in other cases to competition between private and public suppliers. Commercialisation and competition threatens the principles of universal and affordable access and leads to exclusion of lower income groups and poorer regions. An alternative trajectory requires the restoration of public control in these sectors, be it as direct and exclusive public provision or the tight and efficient public control of parallel private provision. Public provision is certainly appropriate for the whole range of educational and a minimum level of cultural services. For most of the other services, experience shows that commercialisation and private provision are generally neither more efficient nor less expensive, and certainly less comprehensive than public provision (gas, electricity, water, even telecommunication). Therefore, there is no tenable argument that they should be private.

The role of the public sector for political democracy A well functioning democracy requires:

- the guarantee for equal treatment of every citizen by public authorities, regardless of his or her economic or social status, race, sex, age and individual orientations;
- the real chance for every citizen to participate in a relevant way in the discussion and decisions about the structure and development of the society they live in, and, on this basis;
- the exclusive assignment of the right to use coercive power and force to democratically legitimised and controlled public authorities.

Such requirements cannot be fulfilled through profit-driven private competition amongst suppliers and the "exit" (Hirschman, 1970) option on the side of the people as consumers, which have led to a progressive "commercialisation of citizenship" (Crouch, 2004, p. 80) and "the emptying of democracy" (Cella, 2008, p. 338). They require a strong basis of public institutions. These relate to two basic areas: on the one hand, the administration and public authority side, and on the other hand, the empowerment or participative side. The tasks of *public administration and exercise of public authority* should not be privatised because this would inevitably endanger the principle of equal treatment of every citizen. A privatised administration

stands under competitive pressure to rationalise and cut costs, which entails a bias towards reduction or outsourcing of services, introduction of fees and exclusion of low-income groups from administrative services. The *empowerment and participatory aspect* of a well-functioning democracy require well-informed individuals with developed abilities to analyse and assess societal problems and to make solid and independent judgements. These properties are promoted through education, the media and an open space for discussion.

The task of *education* is not only to provide knowledge and professional proficiency to the individual but to develop personalities with the ability for critical analysis and independent judgements. Under the pressure of competition and 'efficiency' these tasks are regularly disregarded and education is narrowed down to the exclusive preparation of individuals for the challenges of the labour market. Comprehensive education which is functional for democracy is necessarily a public domain and must not be put under competition of profit-oriented providers. It should on all levels be financed through taxes.

The *media* play a crucial role for the functioning of democracy. While the provision of information and opinions cannot and should not be an exclusive domain of the state or other public bodies, these have the task to guarantee a media landscape which provides comprehensive information and balanced opinions and arguments for debate, to enable all individuals to form their own opinions and judgements.

A participatory democracy also requires not only the creation of the capability of individuals to understand and assess societal structures and problems but also the *space and opportunity* for discussion, opinion building and decision making. It is therefore an essential task for the public sector to organise public events, forums, panels and so on at all levels, including particularly the local level. Such public events are a space for competition, albeit not economic competition for profit but discursive competition of arguments for the organisation of society.

16.3 Challenges of public sector governance

The re-establishment of a strong and democratic public sector requires not only the identification of areas and sectors which should be governed by public interest providers instead of private firms and the profit maximisation mechanism, but also requires the elaboration of alternative management tools and techniques. This is one of the most difficult challenges, not only for the conduct of practical policy, but also for the development of coherent, convincing and viable conceptions, and much research remains to be done (see Clarke, 1994).

The recourse to the management methods of the existing public sector which has survived the various waves of privatisation offers little help, because the development there has during the last 20 years gone into the

opposite direction. State-owned enterprises – like the German railroad corporation Deutsche Bahn or the French gas provider Gaz de France – have been trimmed to become global players and profit maximisers; and the management of public institutions and administrations has been increasingly pushed into the direction of 'modern government' and approached the techniques of private corporations. This tendency is reflected in the rise of 'New Public Management' literature (see Krems, 2008; OECD, 2005), which claims to show ways to improve the efficiency of public administration and to generate better performance at smaller costs.

This literature is, on the one hand, to a certain extent a response to the sometimes poor quality of traditional public services: intransparency and bureaucratic structures, lack of reliability and modernisation. On the other hand, it is an answer to the pressures on public budgets, which was partly self-induced through tax reductions. While in such reform models a public sector is formally accepted as existing reality, its content and functioning is gradually changed and transformed into private corporate techniques and integrated into a model of competitive markets. The public interest is more and more seen as the compilation of individual preferences of customers on markets, and public services are transformed from social rights into commodities offered on these markets.

Commercialisation of public services establishes a simplistic pattern of governance and assessment. It is based on the model of profit maximisation which is equally simplistic because it can be operationalised and its performance can be measured in straight figures. In the new public services model there is a tendency to disregard everything which cannot at all or hardly be translated into output figures. This is also true when additional parameters for quality management or participation are added. In reality, there are enormous difficulties to translate general public interest objectives into concrete guidance for action and measures. For instance:

- How should the objective and efficiency of education be defined? There seems to be a broad consensus that education should not be limited to the appropriation of skills and techniques for a professional career, but also include a broader knowledge of the world as a whole and contribute to the formation of independent personalities capable of analysis of problems and solutions (see Chapter 10). The same is true for health care. The concretisation of such 'visions' is an extremely complex process.
- How can the generally accepted claim that management in public administration should be a democratic process in which the employees should participate and have influence be organised in a more than declamatory way. Often we find that round tables or employees' working groups in the context of change management are simply discussion groups without real influence and power.

Raising these objections against the one-dimensional conceptions of public sector management does not imply that there is no need for further development and change of the traditional structures and management methods. Neither their traditional deficiencies, nor the need for modernisation, nor the current fiscal pressures can be denied – although the latter should be addressed more by enhancing public revenues than by public sector reforms. But even without the current fiscal pressure, public services should operate in a transparent way, use resources cost-effectively, and develop methods to monitor the performance of a service and the capability to take corrective measures if declared and agreed goals are not met. And it is also reasonable to complement these – more static – tools by techniques to adjust the size, structure and quality of public services to changing circumstances and political priorities (see Whitfield, 2001, chapter 9). But such tools and techniques are more complex and difficult to develop than through imitation of the competition-for-profit-model. There are different ways to deal with these problems.

One approach is *decentralisation* and reduction to smaller units of discussion, decision making and organisation. In the European construction this approach is reflected in the concept of subsidiarity which is firmly rooted in the EU Treaty. It requires the assignment of competence for political decisions to the lowest possible level on which the respective public tasks can be managed. A strong pillar of this approach are municipal and local enterprises and their respective federations in the EU (European Local Public Enterprises Barometer, 2008).

Another approach to the problem is the concept of a *solidaristic economy*, often concretised in local or regional cooperatives or other forms of cooperation and self-organisation (see Monzon and Chaves, 2008). Such projects are, on the one hand, often a step forward, when they increase transparency and the degree of participation for their members and broaden the basis of discussion and concretisation – and necessary modification – of objectives. On the other hand, they are facing several problems. First, how do they organise contact, communication and division of labour with other small and decentralised units? Second, how do they participate in large-scale projects like railroads, telecommunication, complex research and development projects? Thirdly, how do they deal with money; if they use their own money, what is the exchange rate to the national or – in the monetary union – the European currency?

A third way to organise the public sector is the introduction and/or enhancement of relevant *democratic participation* to all levels. More worker participation at the workplace and in the control of firms and corporations, including development and investment control; more influence of social movements and initiatives in decisions about regional and local development; more accountability of administrations, politicians and parliaments

to their constituencies; more public discussion and relevant influence on the structure and volume of public expenditure and taxation; more referenda on all levels and so on (see Whitfield, 2001, chapter 9).

16.4 A European public sector?

The essential functions of the public sector for economic strength, social inclusion and political democracy stands in strong contrast to the very limited role it plays in the EU Treaty, in its present form as well as in the conception of the Lisbon Treaty. Although formally neutral with regard to all forms of property regimes (Article 295 EUT) in reality the treaty does not recognise a public sector outside the framework of the private competition model, except for two cases: the first are public not-for-profit-services which are completely provided for free by public authorities, and the second one are narrowly restricted exceptions from the overarching single market and competition rules. All services which are provided 'for remuneration' regardless of the final source of finance fall into the framework of the single European market (Articles 43 and 49 EUT) and competition rules. These apply in the view of the Commission not only to infrastructure and network services but also to most traditional social and health care services and increasing parts of education. The reason for this is, that the organisational developments, economisation and new management practices in these areas, too, have led to the fact that such services are increasingly provided against remuneration, even if they are completely financed through public resources. Only within this overarching framework can narrow exceptions from the competition rules be granted for 'services of general economic interest' if this interest cannot be achieved otherwise – and even then such exceptions are only permissible if they do not impede trade between member states (Article 86,2 EUT).

This restrictive interpretation of the public sector is not acceptable. The alternative is the explicit acceptance of a not-for-profit public sector and its integration into the EU Treaty. The public sector should be treated as a *genuine alternative and second pillar of reproduction* in its own right instead of an exception to the world of competition. It should not be limited to non-economic activities, but include all economic and non-economic activities provided in the public interest – by public enterprises or organisations and by private regulated enterprises. The definition of public interest and therefore of the services and assets which should be regarded as public goods and services is a deeply political matter and should in the first place – following the principle of subsidiarity – be left to the member states and, according to their respective constitutions, to their regional or local levels. This competence of definition preserves and strengthens the diversity of the different social models in the EU.

This does not mean that there is no room for the public sector in the European Treaty, or even for a European public sector. Six perspectives can be mentioned here:

The first European perspective is the *creation of space for the public sector,* that is the explicit acknowledgement of the role of a broad public sector, which is not limited to non-economic services, and the implantation of this acknowledgement as an important element and pillar of a progressive economic, social and political order in Europe in the treaty or a new constitution. This requires the removal of all attempts to restrict this sector, and the development of a democratic culture of discussion and cooperation, underpinned by corresponding institutions. In particular, it should be clearly stated that the single market and competition rules do not apply to the public sector and its activities.

The *second* European perspective is the formulation *and implementation of European minimum standards* for core public interest services, social services, health care, pensions, education, media, cultural services, political structures and other services which are regarded by the member states as falling in the area of public interest. Such minimum standards could be formulated in quantitative terms – like a definition of a share of expenditures for social services in Gross Domestic Product (GDP) or the percentage of doctors or teachers in the population – or in qualitative terms, like level of accessibility of public services and so on. They should include a bias for upward convergence and not permit the reduction of standards in countries where these are already higher than the European minimum requirements. The implementation of such standards should not be limited to recommendations to member states but include active support – technical and financial – to those states that are lagging behind and have difficulties to catch up. Such activities require the set-up of European institutions and higher resources for the EU budget.

A *third* European perspective for the public sector is the *cooperation of existing national or regional public services*, for instance in health care, local transport and cultural services in border-regions, or harmonisation of technical standards for the provision of public services – like, for instance, telecommunication, postal or railway services throughout Europe. A European provision for such cooperation is already in place for social security (regulation 883/2004), and this could be extended to other public services as well. For instance, on the level of regional and industrial policy a much tighter European perspective is recommended to arrive at an efficient and balanced intra-European division of work.

The *fourth* European perspective for the public sector is a *European industrial policy. Public infrastructure programmes* under the leadership of the EU and appropriate European institutions and corporations are the first component of this industrial policy. Large European projects, consortia and

corporations owned jointly by the member states and/or the EU are conceivable and – in the light of unsatisfactory experience – preferable to liberalisation and market-driven structures and performance. The Kopernikus programme recently proposed for a global control of environment is an example of infrastructure programmes based on spatial technology. Other and more traditional potential areas for such projects are transport (railways, waterways, motorways) and telecommunication structures, as already proposed in the Trans-European-Networks plan in the 1993 White Book on Employment and Growth by the Delors-Commission. Their implementation would require a mixture of cooperation of member states and activity on the European level.

A *fifth* European perspective for the public sector is the establishment of new European institutions for *research and innovation* policy. They should deal with the most urgent problems of the EU: development of a new energy regime, mastering climate change and medical research and other issues. They should be financed through member states' contributions, the EU budget and through loans from the European Investment Bank (EIB).

A *sixth* European perspective relates to the *institutional framework* for democratic economic and social policies. The global financial crisis has clearly demonstrated the pernicious consequences of the absence of such a framework of an 'economic government', which should integrate the European Central Bank (ECB), the EIB and central authorities for fiscal policies, taxation and structural development. A European economic government cannot replace national governments but it can, if based on democratic structures and procedures, set-up a guiding framework for coherent and efficient policies on the national and European level and thus strengthen a progressive European Social Model.

16.5 Concluding remarks

A stronger public sector and better public services as a basis for a progressive ESM require larger public budgets – on the national and on the European level. These should be financed from three sources. First, if the public sector fulfils its mission to strengthen the basis for full employment, and the development of the productive resources of an economy it will generate higher incomes as a solid and reliable basis for public revenues. Second, tax competition among member states undermines the revenue basis for the public sector, therefore it must be stopped. An efficient public sector requires higher and not lower shares of tax revenues in GDP, and as the examples of the Scandinavian countries show these are socially accepted if the performance of the public sector is regarded by the people as satisfactory. The race to the bottom in corporate tax rates must be ended, the tax base should be harmonised and a minimum rate introduced for all member states. Also new EU taxes – on CO2 emissions, energy consumption and/or

financial transactions – should be introduced to finance a higher EU budget which is necessary to implement joint European public sector programmes. A third source of finance for European public sector initiatives is the EIB, which is itself a public corporation owned by the EU and can refinance itself at favourable conditions at the capital markets.

A strong public sector cannot play its beneficial role in society if it acts in isolation from or contradiction to the political environment, particularly macroeconomic policies. Therefore, it is essential that the currently existing straitjackets for monetary policy – the exclusive fixation of the ECB on prise stability – and fiscal policies – the Stability and Growth Pact and the narrow framework for the European budget – be relaxed or removed.

References

Cella, G. P. (2008) "Citizenship, the Market and Democracy", *Transfer*, Vol. 14, No. 2, Summer, pp. 333–349.

Clarke, Th. (1994) "Reconstructing the Public Sector: Performance Measurement, Quality Assurance, and Social accountability", in Clarke, Th. (ed.), *International Privatisation. Strategies and Practices* (Berlin, New York: Walter de Gruyter), pp. 399–431.

Crouch, C. (2004) *Post-Democracy* (London: Polity Press).

European Local Public Enterprises Barometer (2008) *Trends and Guidelines for the Future of Local Enterprises* (11th European Conference of Local Enterprises, Brussels, 17 November).

Heintze, C. and Lehndorff, St. (2009) "Der Staat als Investor und als Dienstleister im gesellschaftlichen Interesse", in Arbeitsgruppe Alternative Wirtschaftspolitik (ed.), *Memorandum 2009* (Köln: Papyrossa).

Hirschman, A. O. (1970) *Exist, Voice and Loyalty: Responses to Declines in Firms, Organisations and States* (Cambridge, MA: Harvard University Press).

Krems, B. (2008) *Neues Steuerungsmodell/Wirkungsorientierte Verwaltungsführung/New Public Management* (Online-Verwaltungslexikon www.Olev.de Version 2.04).

Monzon, J. L. and Chaves, R. (2008) "The European Social Economy: Concepts and Dimensions of the Third Sector", *Annals of Public and Cooperative Economics*, Vol. 79, Nos 3–4, pp. 549–577.

OECD (2005) *Modernising Government. The Way Forward* (Paris: OECD).

Whitfield, D. (2001) Public Services or Corporate Welfare. Rethinking the Nation State in the Global Economy (London, Sterling, VA: Pluto Press).

17

Social Actors – Trade Unions and Social Movements

Miren Etxezarreta and Marica Frangakis

17.1 Introduction

The political economy model put forward by the proponents of privatisation considers the rent-seeking vested interests, that is, the incumbents, as the main opponents to privatisation. In practice, resistance to privatisation has been much more broad based, including a range of social actors: trade unions, social movements, political groupings, community organisations, consumers, professionals, environmentalists (especially in the case of energy), and so on.

Such resistance emanated from the fact that privatisation was largely associated with a negative social impact, including job losses, the spread of flexible types of employment, rising income inequality, and so on. Furthermore, it did not deliver in terms of sizeable price reductions, due to an ambiguous effect on productivity. For example, in a comprehensive study of the economic aspects of mass privatisations in the UK, Florio (2004) concluded that the overall effect of 'the Great Divestiture' on efficiency has been modest and that privatisation had a substantial regressive effect on the distribution of incomes and wealth.

The central issues around which the social opponents to privatisation have rallied include high prices and profits, job losses, poor accessibility and reliability of service (especially education and health), reduced social security, environmental policy, public accountability, national control and corruption. Generally, opposition has been based on the perceived conflict between privatisation, on the one hand, and equity and social welfare, on the other. Furthermore, in the case of the privatisation of social services and public utilities in particular opposition is based on the perception of the loss of citizenship rights, which are converted into commodities to be purchased on the market.

Public disenchantment with and resistance to privatisation has meant that governments have become more covert in their support of privatization policies, which have also become more sophisticated. For example, the Private

Public Partnerships and the Private Finance Initiatives – some of the latest forms of privatisation – obscure the fact that it is the private sector that mainly gains from them. It has also meant that privatisation is an issue that may influence electoral results and therefore the behaviour of political parties.

Thus, whereas in the 1980s privatisation was presented as a sign of progress, in the 1990s and 2000s it has acquired negative, social connotations, so that few political parties are prepared to champion it outright. On the contrary, it has been known for campaigns against privatisation to be supported by and be supportive of specific political parties (Hall et al., 2005).

In this chapter, we shall examine two major social actors resisting neoliberal policies in general and privatization policies in particular. Our review will encompass the role of the trade unions – a traditional social actor directly concerned with changes in the work regime – in Section 17.2, and that of the social movements, a relatively new social actor, the influence of which is growing, in Section 17.3. Section 17.4 summarizes and concludes.

17.2 Trade unions

Trade union membership The trade unions constitute the most traditional type of organisation, aiming at protecting worker interests over a large range of issues, including working conditions, pay, prospects, and so on. In the aftermath of World War II and the economic boom that followed, the trade unions increased in strength, in terms of membership, organisational structures, finance and negotiating power. This is especially true of the trade unions in Western Europe, as the experience of the unions in the countries under a Soviet-type regime was quite different, as we shall see below.

In the late 1970s and early 1980s, the onset of neo-liberal policies, including market liberalisation and the privatisation of state property, worsened the terms and conditions of work. Not surprisingly, the unions resisted such changes. However, this was an unequal struggle, in view of the fact that the implementation of such policies weakened the unions in a number of ways, through the spreading of flexible labour contracts, increased unemployment, reduced membership and financial resources. This was in fact a central political aim of privatisation policy – namely, to suppress the unions. In this sense, the unions were both a force opposing privatisation and one that was being negatively influenced by it.

Table 17.1 shows union membership and density in the EU and in selected countries in 2003, as well as changes over the period 1990–2003, when the bulk of privatizations occurred in Europe, where (1) 'density' denotes the proportion of union membership to total wage and salary earners in employment and (2) union membership, in both absolute and relative terms, is employed as a 'summary' – albeit not a full – indicator for the evaluation of the strength of the unions.

Table 17.1 Union membership and density in the EU and selected countries

	Membership		Density	
	2003	**1990–2003 % change**	**2003**	**1990–2003 % change**
EU	36,261	–7.6	26.3	–6.7
Germany	7,120	–11.2	22.6	–8.6
France	1,830	–7.0	8.3	–1.9
Italy	5,327	–9.3	33.7	–5.1
UK	6,524	–27.1	29.3	–10.0
Ireland	516	16.9	35.3	–15.8
Finland	1,495	–2.1	74.1	1.6
Sweden	2,984	–8.5	78.0	–2.8
Norway	1,109	7.3	53.3	–5.2
Denmark	1,710	–2.6	70.4	–4.9
Netherlands	1,575	16.9	22.3	–2.0
Belgium (2002)	1,850	12.4	55.4	1.4
Spain	2,197	84.1	16.3	3.7
Austria (2002)	1,151	–16.3	35.4	–11.5

Source: Visser (2006), Tables 2 and 3

As we can see, over the period 1990–2003 union membership declined in 8 out of 13 countries, while density declined in 10 out of 13 countries.[1] Such a general downward trend suggests that there were common structural and cyclical factors at work. Such factors include the growing flexibility of the labour market, the shrinking of the public sector, where unionization has traditionally been high, the increasing share of the services sector, where unionization is traditionally low and the increasing rate of unemployment, over the period in question. As concluded by Visser (2006, p. 46), "unionization in manufacturing, together with public sector unions still constitute the vertebrate of today's labour unions and federations in terms of bargaining power and wage setting." As the public sector and especially public services are increasingly threatened by privatisation, this is going to lead to a further deterioration of trade union membership and strength.

The findings of Schmitt and Zipperer (2009) with regard to the United States are also pertinent in this respect. In particular, starting at the end of the 1970s, American employers began to engage in the systematic and widespread use of illegal firings and other aggressive legal and illegal tactics against pro-union activists. Thus, it was found that in the 2000s workers

were illegally fired in over one-in-four (26 per cent) of union election campaigns, up from about 16 per cent in the late 1990s. Overall Schmitt and Zipperer conclude that "Our findings provide significant support for the view that an important part of the decline in private-sector unionization rates is that aggressive – even illegal – employer behaviour has undermined the ability of workers to create unions at their work places" (Schmitt and Zipperer, 2009, p. 1).

Trade unions in the Central and Eastern European countries The role of the trade unions in the Central and East European (CEEs) has been quite different to that in Western Europe. Generally, the greatest challenge they faced in the late 1980s was an almost complete change in paradigm, from corporations with guaranteed membership to voluntary associations of employees. Further, their role changed overnight from one of working closely with the management and with the state, to one of having to conduct collective bargaining and industrial action. Industrial relations in the CEEs are today characterised by the following main features: (1) the state continues to play a dominant role; (2) bargaining policy is most often conducted at a company, rather than at a sectoral level; (3) unionisation is largely non-existent in the Small and Medium Size Enterprises (SMEs) and in the services sector.

In view of the radical sociopolitical and economic changes happening in the CEEs, promoted mainly through privatisation and liberalisation, the unions often took on the task of monitoring privatisation, in order to ensure that it is carried out in a transparent and efficient way.[2] The continuing weakness of the trade union movement in many CEEs today – with certain exceptions, such as Slovenia – do not allow it to assume a leading role in the opposition to privatisation. This must be viewed within the particular historical and institutional context of the CEEs and the transformation they have undergone since 1990.

Trade union strategies Generally, the strategies the unions have adopted vis-à-vis privatisation have included confrontation, 'hard' bargaining (characterized mostly by critical support of government policy) and 'soft' bargaining (supporting the government's reform programme). We shall give few examples, which are necessarily selective and largely anecdotal.

A well-known case of a trade union confronting the government plans for the reform of the industry in preparation for privatisation is that of the National Union of Mineworkers (NUM), one of the strongest unions in the **UK in the 1980s**. In 1984, the National Coal Board announced the closure of 20 coal mines, leading to a loss of 20,000 jobs. On 12 March 1984, Arthur Scargill, president of the NUM, called for strike action from NUM members in all coal fields. The strike lasted for almost a year, ending on 3 March 1985. During that time, 11,291 people were arrested, 8392 were charged with offences such as breach of the peace and obstructing the highway and

six pickets died.[3] In spite of the human and social cost of the strike, this ended in defeat, as a result of the government's tactics, as well as the discord within the union movement itself. For example, the Trades Union Congress (TUC) did not support the strike.

The coal industry was finally privatised in December 1994 to create a firm called 'RJB Mining', later known as UK Coal. Between the end of the strike and privatisation, pit closures continued, with a particularly intense group of closures in the early 1990s. During the strike, Scargill had constantly claimed that the government had a long-term plan to reduce the industry in this way.

Overall, the UK miners' strike of 1984/85 was a major industrial action affecting the British coal industry. Its defeat significantly weakened the British trade union movement, while it signified a major political and ideological victory for Margaret Thatcher and the Conservative Party, which then proceeded to consolidate its free-market programme.

The resistance to privatisation in **France in the 1990s** provides another example of trade union confrontational activity. In particular, in 1995 the Chirac-Juppe conservative government announced measures to reduce social security provisions – especially pensions and health insurance. This sparked off a strike movement, which lasted for three and a half weeks with an impressive participation rate and railway workers playing a leading role. As a result, the most provocative of the measures – such as the abolition of public service pension schemes, the closure of 6000 km of railway track and the destruction of thousands of jobs at Société National des Chemins de fer Francais (SNCF), the national railway system – were withdrawn. These, however, were temporary gains, to the extent that the thrust of liberalisation and privatisation policy was renewed in the 2000s.

More recent examples include **UNISON** – a UK public sector union with a membership of 1.3 million – resisting government efforts to introduce market-oriented reforms in the National Health Service. For example, in March 2007, over 300 workers at Manchester's mental health and social care trust opposed management plans threatening job losses, the regarding of posts and the privatisation of many teams. Following a campaign that included strike action, it was agreed that there would be no compulsory redundancies, no automatic downgrading of posts, while the threat of privatisation was lifted.

Yet another recent example of social intervention in the privatisation process is that of the Turkish energy trade unions, engineers and other professional organisations, which have established a platform against the privatisation of the Turkish energy sector. The following extract from the platform is characteristic of their stand: "Energy is very important and a public right for human life. Therefore, it cannot be dealt with in terms of any profit-loss account. The notion of central planning and operation cannot be ruled out just for the sake of allegations of 'irrationality' or so."[4]

At the other end of the spectrum of trade union activity vis-à-vis privatisation, there is what may be called a 'soft' bargaining position. An example of this is given by the 'Guidance for negotiators on privatization good practice agreement', produced by the Public and Commercial Services Union (PCS) – with 300,000 members – in April 2008. As stated in the document itself ('Introduction'), "This PCS guidance for negotiators and reps aims to help all union activists involved in dealing with potential outsourcing or privatization situations to use the Guidance to get the best deal for our members, though without prejudice to our position of opposition to privatization."[5]

In more recent years, trade unions have adopted a more active strategy, aiming at strengthening the role of the public sector and at creating broad-based alliances in its defence. In the UK, for example, there is currently a broad political campaign, endorsed by the trade unions and various other organisations and individuals, organising resistance to further privatisation of health services under the slogan 'Keep our NHS public'.[6] In Germany an alliance called 'Bahn für alle' ('The railways for everyone') is campaigning against privatisation. In the Netherlands, the Dutch Trade Union Confederation FNV has launched a 'Time Out' campaign, which demands a moratorium on further liberalisation and privatisation unless it can be guaranteed that negative consequences for working conditions and service quality can be avoided. Furthermore, trade unions are coordinating their actions on the European level.

Trade union initiatives on the European level As pointed out by Schulten et al. (2008, p. 309), "the prevention of liberalization and privatization, as well as their social regulation are defensive strategies…. A more active strategy would require provisions on strengthening the public sector." Indeed, on a European level, trade unions are running two main campaigns, which were started in 2006. These seek, on the one hand, to defend public services and on the other to improve their accessibility and quality. In particular, the European Public Services Union (EPSU) is running a campaign for a EU legal framework on public services, while the European Trade Union Confederation (ETUC) is calling for the support of a petition for 'quality services, accessible to all'.

The EPSU campaign calls for a legislative programme at EU level, which provides a solid foundation for public services to flourish. For EPSU, this can be achieved through "a clear recognition by European policy makers that public services, services essential for a functioning society, are at the heart of citizens' concerns. Quality healthcare, clean water, efficient and affordable energy supplies, easy-access childcare, hygienic waste services, responsive and friendly administration, are all essential to a good quality of life for all people living within the European Union."[7] The campaign is politically active in the EU, pursuing lobbying strategies within the framework

of the European Parliament and Commission, as well as institutions such as the Economic and Social Committee and the Committee of the Regions (see also Marcon and Zola, 2007).

The ETUC campaign involves the gathering of support for its petition for 'High Quality Public Services, Accessible to All', so as to place the issue on the official EU agenda and to give it as wide a visibility as possible.[8] ETUC's starting point is the belief that public services in the EU "must be of the highest standard, accessible to everyone at an affordable price and subject to democratic control and accountability involving both consumers and workers." In effect, both the EPSU and the ETUC campaigns provide a framework for action for the European trade unions, in fighting for strong public services in the EU, outside the sphere of the Single Market and the competitive regime this entails.

Overall, it may be argued that privatisation is a factor accounting for much of the loss or curb of power of the unions.[9] In this sense, privatisation achieved one of its main political and ideological goals. The trade unions resisted, albeit not with long-lasting results, even when they were able to record a victory. However, more recently the trade union movement is pursuing policies aiming at building broad-based alliances in favour of a strong public sector. Examples include UNISON's 'Positively public' campaign in the UK and VER.DI's 'Genug gespart' ('Enough economization') campaign in Germany.[10] Also, concerted efforts are being made by the trade unions on the European level to give public services a legal status that falls outside the EU competition rules. In most such initiatives, an increasingly important role is being played by the newly emerging social movements, which we shall look into in the next section.

17.3 Social movements

During the past few decades another evolution in the social panorama has taken place, as new forms of social organisation have emerged. Broadly, two types of new forms of social organization have appeared, nongovernmental organizations (NGO), mainly dealing with poverty and social exclusion (primarily international but also national) and the generically denominated 'social movements', concentrating basically on the resistance to the consequences of globalisation and capitalism.[11] Some of the latter have also been present in the opposition to privatisation.

It is not possible to map here all the groups and tendencies of the social movements between 1980 and the present, but it is possible to say something about their main features. They are movements that do not focus on labour issues exclusively, as they are more preoccupied with the negative consequences of neo-liberalism and precariousness in its many forms – social, cultural, economic, ecological – and trying to create new political structures of collective action on the basis of self-organised projects.

To a large extent they have been spontaneously created, focusing mostly on particular – thematic – areas of interest, such as the financial markets, tax havens, housing, education, antiwar and antimilitarism, and so on and also on the strengthening of social rights and fighting against repression.

They have emerged as diverse, plural, multiform, temporal, self-organised groups gathering in networks that try to combine coordination of activities and common goals with full independence and autonomy of action of each group. They operate on the national, European or international level, but their international character and the nature of their global connections constitute one of the most novel and interesting element of these new forms of organisation. The international meetings of these networks have become one of the key elements of their public presence. They have been active and taken advantage of the opportunities provided by modern technology, such as the Internet, in order to get organised and grow in terms of members and support.

The social movements are not new, of course. However, as a form of alternative socio-political organisation, they acquired visibility in the May 1968 events in France and in those of June 1969 in Italy, as well as in the mid-1990s, with the Zapatistas in Mexico.[12] The expansion of these new forms of organisation was rapid and extremely varied. In 1999, an impressive demonstration of the vitality of these informal forms of organisation took place in Seattle (USA) during the protests against liberalisation and the World Trade Organisation (WTO). This was followed by a number of international meetings on various levels.

In 2001, the first World Social Forum (WSF) took place in Porto Alegre (Brazil) and it was intended as a counter-summit to the World Economic Forum, that is the annual gathering of the global political and economic elites in Davos (Switzerland). One of the results of the WSF was the call to hold similar forums at regional level and in November 2002, the first European Social Forum (ESF) took place in Florence (Italy). The ESF was an annual event between 2002 and 2004, while it has since become a biannual one.

In addition, the social movements meet and coordinate their efforts on many other occasions, often as counter meetings to official summits of the European and international authorities (Alternative ECOFIN meetings, G-8 and others). Generally, it may be argued that a new European and global public space for discussion, debate and organisation has emerged.

Most of these social movements are actively questioning the legitimacy of neo-liberal policies, enhancing resistance to it and proposing alternatives. Privatisation is one of the policies they reject. An example of such an initiative against privatisation is the campaign led by Compass – a left of centre pressure group – against the privatisation of the postal services in the UK. On the day the British government published legislation to privatise the Royal Mail, Compass sent out an urgent call to recruit new supporters to help stop this, while it produced a report, entitled 'Case not made',

disputing the arguments put forward by the government-sponsored Hooper report on the future of the Royal Mail.[13]

On the European level, the European Network for Public Services was established at the 4th ESF (2006) in Athens, aiming at coordinating actions in order to influence the political agenda. The objective of the Network is "to reinforce the mobilization and the voice of civil society through the exchange of information and of experiences and the elaboration of common positions and initiatives at the European level." In particular, at the ESF in Malmö (2008), a statement entitled 'Hands off our common welfare!' was issued, in which it is stated that "we are convinced that a large coalition is possible between trade unions, NGO's, political parties and citizens' organisations in every country and on a European level. Democratizing public services is a cornerstone of an inclusive European Social Model."[14]

Although many social movements are active in various international campaigns against EU policy, they often pay greater attention to issues, such as ecology, globalisation, world inequality, new forms of consumption, social exclusion, and so on than to the area of labour relations and public policy.[15] In this sense, it is important for the struggle against privatisation and neoliberal restructuring to be pursued by trade unions and social movements in common, ensuring "a broad basis for resistance as well as a connection to the social relations of production" (Bieler, 2008, p. 8).

17.4 Summary and conclusions

Opposition to privatisation has come from a range of social actors. It is based on the perceived conflict between privatisation and equity, as well as the loss of the social rights of citizenship, while it is organised around a number of central issues. In this chapter, we discussed the role of the trade unions in resisting privatisation and in the pursuit of alternatives, as well as the implications of privatisation for the present state of the unions. Furthermore, we reviewed the emergence of the social movements in the fight against neoliberalism and against privatisation in particular.

In the case of the trade unions, it was shown that although in many instances they put up a valiant fight, they were not able to secure long-lasting results. This was an unequal struggle. However, the unions' own weaknesses – political and organisational – account for part of their failure to make an impact on the process of privatisation, especially in the early stages of the liberalisation and privatisation process. However, as public opinion has become more skeptical of the implications of this process, the trade unions have become especially active in resisting privatisation and in building broad-based alliances favouring a strong public sector on the national and on the European level.

In the 1990s, a new form of social organisation appeared, that of social movements, giving rise to a new European public space for discussion, debate

and opposition to neo-liberal policies, including privatisation. The need for close cooperation and coordination between the trade unions and the social movements in pursuing the same goals has been recognized, although the process of their coming together is arguably still in its early stages.

Generally, in response to the social reaction against privatisation, decision makers have tended to resort to increasingly more sophisticated forms and methods of privatisation, some of which were reviewed in Chapters 2 and 3. In this sense, it is an ongoing struggle between opposing sets of interests and forces.

On the other hand, the current financial crisis, which is already turning into an economic one, has led to government bailouts first of the financial system and then of particular industrial sectors (for example automobiles: 'too big to fail'). As the crisis unfolds, a new nationalisation wave is on the way. However, it may be argued that this is some sort of 'asymmetric public intervention', in the sense that it appears to serve business interests primarily – that is, it is 'upward-looking' – rather than those of society at large – or, 'downward-looking'. This is especially so, in view of the fact that the neoliberal orientation of EU economic and social policy, including privatisation, remains practically unchanged. Thus, in the long run, it is important for the social actors – trade unions and social movements, in particular – to strengthen their fight against neo-liberalism in general and privatisation in particular.

Notes

1. In the case of Spain, it should be noted that until 1978 there were no democratic trade unions because of the Franco dictatorship. It took several years for democratic trade unions to become legal and to consolidate. Thus, the remarkable increase in membership represents at least partly the time lag in voluntary union membership.
2. For example, the Confederation of Independent Trades Union of Montenegro (CITUM) describes its position vis-à-vis privatisation as follows: "The trade union is supportive of privatization, but not of its process," to the extent that it is prepared to address the problems affecting its members as they occur during the privatisation process (Duric, 2005, pp. 81–95).
3. Details on the UK miners' strike were drawn from Wikipedia at http://en.wikipedia.org/wiki/UK_miners'_strike_(1984–1985).
4. European Federation of Public Service Unions, at http://www.epsu.org/a/4065
5. The document can be found at http://www.pcs.org.uk/en/campaigns
6. Quoted in Schulten et al. (2008). The relevant sites are www.keepournhspublic.com and www.bahn-fuer-alle.de
7. EPSU, 'What are the main issues for EPSU?' (www.epsu.org/a/4040).
8. The petition can be found at www.etuc.org
9. Hermann and Atzmuller (2008, p. 190) also conclude that "Although there are country-specific differences, liberalization and privatization in general have led to a significant decentralization and fragmentation of collective agreements and bargaining structures."

10. www.unison.org.uk/positively public/index.asp and www.genuggespart.de respectively.
11. Many different varieties exist among them too. Some of these movements have become very big and prominent organisations like ATTAC, Greenpeace, Amnesty International, while there exist an enormous amount of small groups of persons pursuing very specific aims like defending a particular territory from specific building projects or caring for marginal people. Another important feature of differentiation is their willingness to improve the working of the present economic system or their anti-capitalist character.
12. One of the first 'different' ways of social collective organisation took place in Madrid in 1994, where 50,000 people gathered in order to protest against the International Monetary Fund (IMF) and the World Bank, on the occasion of the 50th anniversary.
13. www.compassonline.org.uk
14. www.fse-esf.org
15. Most struggles against the privatisation of pensions in the different countries have been organised and led by trade unions.

References

Bieler, A. (2008) *Hotbed of Resistance or Inconsequential Talking-Shop?* (Paper Presented at the Roundtable on the ESF), www.nottingham.ac.uk/cssgj/CSSGJ_News.php

Duric, D. (2005) "The Privatization Process in Montenegro and the Role of the Trade Union", *South-East Europe Review for Labour and Social Affairs*, No. 1, pp. 81–95, www.ceeol.com.Florio, M. (2004) *The Great Divestiture* (Cambridge: MIT Press).

Hall, D., Lobina, E. and de la Motte, R. (2005) "Social Actors", *Public Services Yearbook*, 6.

Hermann, Ch. and Atzmuller, R. (2008) "Liberalisation and Privatisation of Public Services and the Impact on Employment, Working Conditions and Labour Relations" in Keune, M., Leschke, J. and Watt, A. (eds), *Privatisation and Liberalization of Public Services in Europe* (Brussels: ETUI-REHS).

Marcon, G. and Zola, D. (2007) "European Unions of the People", *Eurotopia*, May, www.tni.org.

Schmitt, J. and Zipperer, B. (2009) *Dropping the Ax: Illegal Firings During Union Election Campaigns, 1951–2007* (Centre for Economic and Policy Research, March), www.cepr.net.

Schulten, Th., Brandt, T. and Hermann, Ch. (2008) "Liberalization and Privatization of Public Services and Strategic Options for European Trade Unions", *Transfer*, Vol. 14, No. 2, Summer, pp. 295–311.

Visser, J. (2006) "Union Membership Statistics in 24 Countries", *Monthly Labor Review*, January, pp. 38–49.

Index

age, 165, 167–9, 170, 174, 179, 181, 183–4, 186
  ageing, 167, 170
allocative efficiency, 113–14, 116
Austrian approach, 83–9

banking, 187–207
  international comparison, 194–8
  liberalisation, 190–2
  privatisation, 191–3, 200
  system, 190
  structures, 188
  two-tier system, 199
Bolkenstein directive, 23
Bologna Process, 157, 161

centres of excellence, 158
citizenship, 221–2, 228, 230
  commercialisation of, 248
collective, 259, 262, 265–6
commodification, 9
competition, 83–4, 88, 90–3, 96, 101–2
  locational, 22
  state, 157–8
current account, 39, 41–2, 47

decommodification/recommodification, 88, 236–7
defined benefit, 165–6, 178, 180–1, 185
defined contribution, 165–6, 169, 178–9, 184
Delors Jacques, 77–8, 82
democracy, 222–4, 227, 230
  democratic accountability, 216, 218
demography, 165–7, 179, 184, 186
  demographic threat, 165
distribution, 166, 168, 181
distributive efficiency, 115–16, 125
draft constitution for the European Union, 78–80
dual economy, 38

ECJ (European Court of Justice), 156–7
efficiency, 84, 91, 93–6, 149
  allocative, 113–14, 116
  argument, 209
  gains, 112–18
  productive, 115
EHEA (European Higher Education Area), 157
eligibility, 170, 174
employability, 157–9
employment
  level in privatised companies: short-run determinants, 100–1; long-run determinants, 101
entrepreneurs, 84–5
equality/inequality, 83–4, 238–9
European Investment Bank, 254
European Social Model (ESM), 77–88, 233–43
  in search for common institutions, 84–6
  Lisbon Agenda, 80
  measuring, 83–4
  neoliberal modernisation, 79–83
  public ownership and, 87
  progressive, 233–43

finance
  -led capitalism, 49, 51, 58
  financial capital, 164–70, 178–9, 181–3, 186
  financial sector, 97–9
fiscal, 167, 186
foreign direct investments (FDI)
  in CEE countries, 38–40
  in CEECs: spillover effect, 99–100
funded, 165, 167–70, 172, 178–83

GINI coefficient/index, 44–5
globalisation, 100–1

healthcare
  access, 130
  choice, 134–6, 140, 142
  competition, 134–6, 138–42
  efficiency, 130, 133, 138–42

healthcare – *continued*
  equity, inequalities, cream-skimming, 129, 138, 140–2
  financing, 130–6, 139, 142
  insurance, 129–35, 139–42: private, 132–5, 139–42; public, 130, 134–5, 139
  marketisation of, 129–30, 133, 135–6, 138, 140–2: contracting out/ outsourcing, 133, 136–7, 139, 141; DRG systems, global budget, pay by results, 136, 140; internal markets, quasi-markets, 133, 136; public-private partnership, 137, 141
  policy/reform objectives, 129–30, 133–6, 138–42
  privatisation, 129, 133, 135, 137–8, 140, 142: in CEE, 36–7
  providers (public/private), 130, 133, 135–7, 139–42: private, 133, 135, 139–42; public, 133, 135–6, 139–40
  quality, 129–30, 133, 138, 140–2
  the role of the EU, 131, 137–8
  spending, 130–1, 134–5, 138
  systems, 130, 134, 136–7: Beveridge, 130, 136; Bismarck, 130, 134; Semashko, 130: *see also* Semashko model
human capital, 146, 149, 154
Humboldtian model, 153

incumbent firms, 113–14, 116–17, 119, 121–3
industrial
  policy, 115–16, 119
  relations, 259
industrial sector in CEECs
  changes of share in employment, 97–8
  changes of share in GDP, 96–7
  impact of foreign direct investments on, 99–100
inefficiency, 91–3
inequalities, 221, 227, 229

knowledge based society, 149, 167

labour market flexibility, 101–2
legal framework for privatisation in CEE countries, 32
liberalisation, 86, 95, 97, 101
Lisbon Strategy, 23
Lisbon Treaty, 78, 80
local economy/industries, 38, 46–7

Maastricht criteria, 131, 153, 155: *see also* Social policy/welfare policy
market failures, 91–2, 113–14
membership, 257–60, 265–6
miss-selling, 181, 184

National Health Service (NHS), 130, 136–7
nationalisation waves, 10
natural monopoly, 93–4, 112, 116, 119, 124–5
neo-classical economics, 89–95
neo-liberalism, 209, 211, 217
network industries' liberalisation, 112–14, 116–17, 119–21, 124–5
new public management, 133, 147, 156, 212

open method of coordination, 138

Pareto efficiency, 113–14, 119, 125
patient choice, 211, 216
PAYG, 166–9, 172, 179–80
pensions,
  private, 164–71, 174, 178, 180–4
  public, 164–5, 167–71, 174, 179, 183–4, 186
political economy of privatisation, 96–103
popular capitalism, 17
portability, 171, 174, 186
price convergence, 117
principal-agent, 92–4
private equity firms, 52–3
privatisation, 87, 89–103,147–51
  endogenous, 147–8, 153, 157
  exogenous, 147
privatisation in CEE countries, 30–47
  economic impact, 37–42
  impacts on the ownership structure, 33
  methods, 32–4
  objectives, 35

privatisation in CEE countries – *continued*
  reasoning behind, 31
  social impact, 43–5
privatisation in post-socialist countries
  and foreign direct investments, 99
  and reduction in employment, 100–1
  and reduction of public deficit, 95
  drivers for: economic, 95–6; political, 96; ideological, 96
  impact on development of industry, 98–100
  impact on employment conditions, 101–2
  impact on position of trade unions, 102–3
  process of, 94
  specific circumstances of, 93–5
professional training model, 153
profits, 83–4, 87–90, 96–7
  profit-repatriation, 39, 42, 46
property rights, 84, 86–7
public
  domain, 222
  enterprises, 145–6
  finances, 99–100
  goods, 223, 228–9
  investment programmes, 247
  monopoly, 113, 124
  ownership, 85–6, 88, 90, 92–6, 100
  pensions, 164–5, 167–71, 174, 179, 183–4, 186
  sector employment, 240–1
  utilities, 85, 93, 98
public private partnership, 119, 137

regulation of public services, 235, 241–2
  active role of the state, 235
  accountability, 235, 242
  democratisation, 242
  participation, 241–2
  sustainability, 242
regulatory authorities, 112, 118
replacement rates, 167, 184
resistance, resisting, resisted, 256–7, 260–4
roma population, 45

Sapir, André, 80–1
second best, theory of, 91
Semashko model, 36, *see also* healthcare
services of general economic interest, 27, 252
shareholder
  activism, 53, 56
  society, 209–10
Single European Act, 22
small businesses, 32–3
social cohesion, 222–3, 227–9, 231
social policy/welfare policy, 78–82, 236–8
  EC White Paper on Social Policy (1994), 79
  european employment strategy, 79
  Treaty of Maastricht, 78–9: *see also* Maastricht criteria
social, 164, 166–70, 172, 174, 179–86, 256–7, 260–5
  actors, 256–7, 264–6
  movements, 256–7, 262–5
  rights 223, 225–7, 229
  welfare, 113–14, 125
solidaristic economy, 251
solidarity, 223–4, 226, 231
systemic
  change in the CEE countries, 30–1
  contagion, 56

trade union, 256–62, 264–6
trade unions position in CEECs
  factors behind decline, 102–3
  in industrial sector, 103
transition countries, 156

unbundling, 112, 117, 121, 126
union/s, 257–62, 264–6
universal service, 115

varieties of capitalism/models of capitalism, 85–6
vocational drift, 157–8, 161
voucher privatisation, 95–6

welfare
  gains, 112–14, 116, 124
  state, 221–4, 226
Western Europe, 145–51
western european welfare states, 84–5
  Esping-Andersen, Gøsta, 884, 236
  social rights, 85
  universal welfare provision, 84
worldwide financial investors, 49